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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Thursday, the 12th day of December, 1963.

C O M M I S S I O N

MR. KENNETH LeM. CARTER — CHAIRMAN

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RESEARCH DIRECTOR

PROF. D. G. HARTLE

SECRETARY

MR. G. L. BENNETT

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Thursday,
December 12th, 1963.
Ottawa, Ontario.

---Upon resuming at 9:30 o'clock a.m.

THE CHAIRMAN: Mr. Secretary, we may now start.

THE SECRETARY: Good morning Mr. Chairman and Commissioners. This morning, today and tomorrow we will have with us the representatives of the Canadian Institute of Chartered Accountants who are presenting a brief. Mr. Howard Ross, F.C.A., President of the Institute, is here this morning together with his colleagues. He wishes to make a few opening remarks and then Mr. A.J. Little, F.C.A., Chairman of the Special Tax Committee will introduce the remainder of the delegation. Mr. Chairman, I would like to enter this submission into the record as Exhibit No. 288.

---EXHIBIT NO. 288: Submission of the Institute of Chartered Accountants.

SUBMISSION OF THE CHARTERED ACCOUNTANTS

APPEARANCES:

Mr. Howard Ross
Mr. A.J. Little
Mr. D. Kelsey
Mr. F.G. Townsend
Mr. R.A. Lachance
Mr. Donald Gordon
Mr. J. Ford
Mr. Bruce B. Philip
Mr. C.W. Leach
Mr. Harry McMackin
Mr. A. Garneau
Mr. W.A. Simonton
Mr. R.D. Thomas

THE CHAIRMAN: Good morning Mr. Little, good morning Mr. Ross. We are overwhelmed and delighted to see you come from coast to coast and just

about everywhere in between. Your submission to us, I might say, is of the quality I would have expected. It is a first rate job. We have read it with a great deal of interest and it is going to provide us with tremendous ~~success~~ assistance in what we are trying to do. Sometimes we invite our legal advisor and counsel to lead the questioning. We do that when we have a particularly weighty submission or when it is very technical. This time we have asked our two legal advisors and counsel to do the job. This is the first time we have resorted to this, I might say. Mr. Ross, I would be glad to hear anything you wish to say to us before we examine this submission. I would be grateful if you or Mr. Little would introduce your delegation. Stand or not as you wish.

MR. ROSS: Mr. Chairman, I think the first thing I should say to you it is gratifying to us as members of the Institute to come here before a Commission presided over by one of our profession. It is a great distinction to our profession to have you in such an important position.

(Mr. Ross speaks in French).

It is very pleasant to have a fellow member in the chair on occasions of this sort. It makes it a little difficult for me to say anything that will surprise you very much in introducing this brief. I would like to confine myself to just a few things, Mr. Chairman, which perhaps I can say more properly than the Committee themselves who have been working on this brief.

In the first place we recognized as soon as your Commission was appointed a particular opportunity we felt for our profession to be of some use to the country. This seems to be a subject which we take terribly seriously from our professional viewpoint. We scoured the country from coast to coast the best tax brains amongst our profession. We went, as you will see when Mr. Little introduces them,from the Maritime provinces to British Columbia to collect this team. It was the strongest team we could collect subject only to the fact, of course, by the time we got around to selecting them two of our best tax brains had been taken as members of the Commission. Apart from that we did our best.

The second thing and the only other thing I would like to say is this Committee has done a tremendous amount of work on this brief, as I am sure you can guess. I don't suppose anybody who hasn't satught through every session can really appreciate the amount of hours that went into this. It has been very gratifying to other members of the profession to have a committee that has taken its job so seriously under the inspired and driving leadership of Mr. A.J. Little and has done a job which I am sure represents the greatest effort of any one submission this Institute has ever put in in its history.

Now, Mr. Chairman, I think that is all I can say before you start to get technical. I would therefore like to turn this part of the proceedings over to Mr. A.J. Little the very competent chairman of

this committee who will look after proceedings from our side from here on in.

THE CHAIRMAN: Thank you very much, Mr. Ross. I have always been very proud of my profession but I have never been more proud than I am now. Mr. Little?

MR. LITTLE: Excuse me, I am standing so I can see the committee members. We are delighted and pleased to come before you and meet with you again. We were here in February of this year. On that occasion most of our team were here. I think I should introduce them all to you again. As Mr. Howard Ross has said the committee is made up of members from coast to coast. Starting on the west coast, Mr. D. Kelsey at the end of the table. On his left Mr. F.G. Townsend from Toronto, one of the members who met weekly with me, as did Mr. R.A. Lachance who is beside him. Mr. Donald Gordon is from Winnipeg. On the far end of the table Mr. J. Ford who is not named as a member of the committee but was seconded by us to assist our sales tax expert who is as you will recall from our last meeting, Mr. Townsend. Mr. Ford has assisted Mr. Townsend on sales tax. Next to him is Mr. Bruce B. Philip who has been employed as our permanent secretary throughout the proceedings and devoted his full time to it for some twelve months. Mr. C.W. Leach is next of Montreal, Mr. Harry McMackin from St. John, Mr. A. Garneau from Quebec City and Mr. W.A. Simonton, from Toronto and at the back is Mr. R.D. Thomas, executive director of the Institute who attended the majority of our meetings. He took no part in the submission, per se, but was a

very great strength to us in correcting our mistakes and in particular in translating our verbage into English.

I has assumed, Mr. Chairman, you wouldn't wish me to read the brief. I have also assumed it, perhaps, is not necessary to summarize but I think there are two or three things I would like to say if I may take a moment.

THE CHAIRMAN: By all means.

MR. LITTLE: First of all I would like to remind the Commission, and I said this when we were here before, of the way in which we handled this job. We didn't employ someone to ghost write a particular point of view for us. We took this work very seriously and the members who had the -- I was going to say good fortune but it wouldn't be the right approach -- who were located in Toronto met every week throughout most of this period except for the summer months and generally for a full afternoon or afternoon and evening to pursue our research work with Mr. Bruch Philip who spent full time, as I say. Everything we did as we went along was submitted to our colleagues in the other cities of Canada. They in turn criticized and commented on what we were doing. In addition to that each of them had a special assignment to undertake on our behalf. One or two of the assignments were given to other members of the profession who weren't members of the Committee. Taking it in toto we think we have had, perhaps, more individual thought and effort devoted to this than, perhaps, anything else we have done so far. While we

have presented this as a presentation of the Institute I think it would be fair to say that the counsel of the Institute, and Mr. Ross will bear me out, have never seen the brief. Our Term of Reference was if we could come up with a majority report and no minority view that we didn't need to submit it to the counsel for approval and we could submit it directly to you. Reaching a majority view on this committee wasn't easy and I should say that in a number of instances throughout the brief we weren't in fact, unanimous. I think we can acknowledge at the start that one or two very important areas, the concept of income for example, the solution for the surplus distribution problem, we weren't unanimous but we set a guide line for ourselves at the start, if we could reach an 80, 20 view then we would go together on it. If we reached a situation where it was a five to four situation then we would have to try again and either present a minority report or put in two viewpoints, stressing neither. There has been a definite suggestion amongst my members that if it was 80, 20 I had eighty votes and they had twenty. I assure you that is not the case. All I have done is to stick handle the views that have come forward. We have in most cases in this work a unanimous view, and in some of it we have some support for another approach, but in which case it is a majority approach.

If I may I would like to stress to the Committee and more particularly to counsel that all the members who are here today have come as working members, and not as spectators. We have divided the report up

chapter by chapter and each one here is not only an expert in the whole field of taxation, but particularly an expert on one or more of the chapters. My function, they have made perfectly clear to me is to simply assign the questions as they arise. If that is acceptable to the Commission, Mr. Chairman, that is what I would propose to do. If I have any comment of my own I assume there would be nothing wrong with my putting it forward at all.

THE CHAIRMAN: Thank you, Mr. Little. Before I am through with this task I shall seek your advice as to how to get the other members to do all the work and secondly how to seek unanimity. Perhaps the latter is the more significant.

COMMISSIONER WALLS: You mean on the same 80, 20 basis.

THE CHAIRMAN: Now, we have, as you know, set aside two days for this task. It seems to be best that we should proceed, as far as we can on it in one day carrying the rest to tomorrow. I would think it most unlikely we will get through in one day, but if we can all to the good. Let me introduce to you Mr. J.L. Stewart who is legal advisor and counsel, probably known to many of you. Mr. Stewart will lead the questioning. We might proceed.

MR. STEWART: Thank you, Mr. Chairman. Gentlemen I would like to start Chapter 2 which is entitled the Concept of Income and to discuss with you in the first instance the first point which you deal with which is the question whether the Act should

expressly provide that subject to specific provisions of the Act income should be determined in accordance with generally accepted accounting principles. Now, I appreciate from what you say in chapter 2 and in the related appendix that it is your view that this change in the Statute should not be made. I would like to discuss that. Might I say that in opening up that discussion I should like to refer to one of the most recent publications of your Institute, namely a booklet entitled Accounting Problems in the Oil and Gas Industry which you published recently under the name of Professor W.B. Coutts.

This may seem at first sight to be an unlikely place at which to begin, but I discovered on browsing through this pamphlet that it was written at the instance or as the result of a study group which was formed in western Canada and composed of some distinguished accountants who were concerned with the problems of the petroleum industry. It appears from page 1 of this book that not only is there some question as to what the generally accepted accounting principles are, but there is actually a question in your industry as to what accounting is. I would like to read, if I may, a paragraph from page 1 in which the author has been discussing the work of this study group which was concerned, of course, with the existing accounting problems in the petroleum industry. He says:

"This review of present
and proposed accounting principles

and all the arguments marshalled in support of them has led to the conclusion that many of the difficulties experienced ....

(Continued on Page 6540)

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arose from a general failure to agree on the ultimate purpose of accounting and of definitions which accountant's statements are intended to perform."

Well, he then decides in the circumstances he had better deal with this question before getting into the specific problems of accounting in the petroleum industry. I would like to refer, if I may, to certain points he makes in this early part of this work and get any comments you may have, as I go along.

He is obviously dealing here with accounting for corporate purposes and Section 3 of this booklet is entitled "Needs of Shareholders and Managers." He says on page 7 and I quote:

> "Because of its restricted field of activity, accounting cannot supply all of the information needed by shareholders and managers. Within its limits of competency, however, it would appear that it can meet these needs best by providing statements of income and financial positions which will provide the following."

Then he indicates first what he thinks should appear in the income statement.

Again I quote:

> "With respect to income a figure which is: (a) realistic and reasonable; (b) comparable with the income of other periods and of other enterprises; (c) calculated with due regard for the pattern and purpose of the enterprise's operations; and (d) reported in sufficient detail to enable the user to

understand the nature as relative significance of each class of revenue and expense, to evaluate the significance of changes in the period reported, and to estimate the effect on them of future events."

I do not know whether there would be any dissent fromthe principles set out there as to the function of the income statement. If there is not, I will go on.

On page 9 where he indicates that the accounting income is just one type of income, he distinguishes between real and economic income on the one hand and accounting income on the other.

He says this at the bottom of page 9.

"The difference between 'real' or 'economic' income and accounting income arise principally from two sources. The first of these is the accounting practice of measuring values exclusively in terms of money so that increases or decreases arising from changes in the value of money itself are not distinguished from those which represent real changes in relative values. The second sources of difference arises from the accountant's practice of ignoring changes in value until they are 'realised' by sale or exchange for money or money's worth."

There, again, that is, of course, a statement as to the two principal differences between those two types of income, between income ascertained from those two points of view.

Then I find at page 11, it is now being argued that income account should recognize changes in value as they occur and the point is that changes in value may orrucr for peculiar or fortuitous reasons, as well as because of general or inflationary price changes.

Then at page 12 he says, as he sees it, there is a trend or increasing view in the profession that the income account should recognize changes on the market values as they occur, and then he says this matching principle, with which we are all familiar and about which we have heard a lot, that this is the result, if you like, of the realizations drop and he says on page 13:

"It is unfortunate that, except in the simplest cases, it is seldom easy to match costs and revenues with any degree of ease or accuracy."

He says that these problems require a combination of a number of more or less arbitrary secondary rules or principles, such as "first in, first out," "straight line depreciation" "absorption costing" and so on, to give some guidance in the matching process.

Then I will quote a paragraph on page 13.

"It is obvious that, whenever such assumptions are necessary, the income determined will differ in a greater or lesser degree from the 'real' or economic income for the period. It is also obvious that normally there will

be more than one figure possible for income. In such cases the choice between methods must be guided, like all other choices in accounting, by the relative usefullness of the results produced."

Now, these points I have mentioned were of considerable interest to me as a layman in these matters. And I realise to you that they may be the broadest generalities but I thought it might be useful to state them as a sort of background to our discussion and as I say, if there is any real dissent from the line that Professor Coutts has taken, I thought it would be interesting to have it at this stage.

MR. LITTLE: Mr. Chairman, if I may start the reply; I should say at the outset that we are extremely conscious of our responsibilities in this area, mindful of the fact that at our earlier meeting with you you placed particular importance on this matter and asked if we would turn our attention to it, which we have done.

We discussed it amongst ourselves in the Committee on a number of occasions and we were not able to bring ourselves to the conclusion that the Act could be strengthened by the introduction of words such as "in accordance with general accounting principles or practices."

The more we thought about this the more we felt it was something that an ad hoc committee on taxation ought not to resolve on behalf of the Institute of Chartered Accountants, and we had the good sense,

I think, to refer this matter back to the Institute and to suggest that it be given the help and guidance of the Committee during our research.

I think when we get into this matter, we can review the reasons for and against this approach. I am not surprised that this is the first question on the order paper because I think without question it is the number one fundamental question in the whole approach, with which we had to deal as well.

I may just say in passing to counsel when he referred to us as an industry, I assume he may have meant in the gas business and not to us an industry. We lag behind his own trade but we do think of ourselves as a profession.

MR. STEWART: Mr. Chairman, if I made that remark, I humbly apologize.

MR. LITTLE: With that proviso, I think perhaps Mr. Stewart, you have us at a slight disadvantage because I personally am not as conversant with Professor Coutts' statement as obviously you are. I am not at all sure that any of us really have made a study of it.

You asked whether or not we agreed with it. In general terms, I think, as I listened to it, I could find nothing in it with which one would quarrel.

Although he states a general proposition, he is dealing with a particularly difficult industry in which the determination of an ~~in~~ income is perhaps as difficult as any one could find. Therefore, I do not quite appreciate the distinction between econom ic income and

cash in the bank.

I am not sure that in response to your question, Mr. Stewart, that we will in fact be able to deal with the areas, phrases and paragraphs you have quoted to us, one by one. I think perhaps, what we should do, if I may suggest it, Mr. Chairman, is to put forward our view again on this problem and then in the light of that perhaps Mr. Stewart can go back to the things that he has quoted to us to see whether there may be some differences of approach or differences of view.

Mr. Campbell Leach has kindly undertaken to assume the major burden of responsibility for speaking on this point. If I may, I would like to suggest at this point that Mr. Campbell Leach speak to the view we have put forward.

THE CHAIRMAN: Thank you. Mr. Leach?

MR. LEACH: Mr. Chairman, this, of course, is an interesting and vital subject for us. Mr. Little has described how we have dealt with this by obtaining the views of the Auditing, Accounting and Research Committee. You have their comments in Appendix C. I presume you would not wish me to go over that in detail.

I think the essence of their opinion and ours is that an attempt to tie down "generally accepted accounting principles" into the Act would operate to the disadvantage of both.

The development of accounting principles is going on continuously and there is a fear that, if the law and jurisprudence became involved in this, it

would tend to slow down our development, affect our judgment and things like that.

Conversely the law would necessarily have to pay continuous attention to our side of it. This might affect the jurisprudence. It might require continuous amendment to the Act and so we suggest that it would turn out to be a rather untidy operation over a period of time.

I think the blunt fact is that accounting principles are not sufficiently well codified to be fully effective for this purpose. I think Professor Coutts touched on that in the booklet which Mr. Stewart has quoted.

We are continuously working on the subject. The phrase "generally accepted accounting pricniples" was developed and has been promoted in the United States. Formerly in earlier years I think it would have been said that generally accepted accounting principles were those which were recognized in the accounting bulletins of the American Institute and in the bulletins of the Canadian Institute and that you would also have to refer to a mass of written opinion which would have to be submitted to clarify any particular point, so generally accepted accounting principles then are found in a mass of materials which have not been codified.

In recent years, I think perhaps 4 or 5 years, there has been an Accounting Princples Board established by the American Institute and they are making very very slow progress. They have even, I believe, had to reorganize and start again and so attempt

to codify the general accepted accounting principles.

There have been some tentative releases. It is quite evident it will be a very long time before anybody can say that here is a compilation to govern the meaning of these words. It is for these reasons we think it would be premature to tie ourselves down to any thing.

MR. STEWART: Well, now --

THE CHAIRMAN: Are you finished, Mr. Leach?

MR. LEACH: Yes, if Mr. Stewart has a question.

MR. STEWART: I am sorry. I thought Mr. Leach was finished.

THE CHAIRMAN: I was judging by an intake of breath, I am afraid, and a gesture.

MR. LEACH: The point in the differentiation between economic income and accounting income,economists are somewhat philosophical and sometimes accused of being precise. We are a very practical profession. We have to be because we are dealing with business. Therefore, it is essential that we must have certain methods of being precise about a subject and that is why these so-called postulates have been developed which are the starting point for accounting principles.

Postulates are such considerations as the business must be considered as a going concern, that income must be recognized as realized, when realized and things like that.

I think that is the real answer to the apparent conflict or contradiction between economic

income and accounting.

I have some other points, Mr. Chairman, but perhaps Mr. Stewart has a question.

MR. LITTLE: Perhaps I might just interject a little further reply from this side to the question, Mr. Chairman. I would like to do two things. I would like to make a comment myself and I would also think it may be useful for the Commission's members to hear from the Executive Director of the Institute about what the significance is and the standing is on this research study on this subject and to what extent that is to be considered a pronouncement of the Institute or whether this is simply a study that has been done on it.

Mr. Thomas might just deal with this subject so that ordinary people would know what the significance is of research study.

THE CHAIRMAN: Do you mean the research study that is embodied in Appendix C?

MR. LITTLE: No. I mean research study from which your counsel is quoting.

MR. STEWART: I think I should perhaps say I opened this up as a matter of interest and without intending to make very heavy weather of it. All I was going to lead up to was I have a number of questions on this particular subject. There are different kinds of income. There is income that is real or economic income. There is income for corporate accounting purposes. There is income for tax purposes. These things are necessarilly different.

If, in my earlier remarks, I indicated that or if an inference was drawn that I attached a great deal of importance to this, that is unfortunate. It does not seem to me that to suggest that there are different types of income or that income is for different purposes is a particularly startling remark, but if it is, then let us explore it.

MR. LITTLE: Mr. Chairman, perhaps I attached too much weight to this point. I had rather the feeling that counsel was quoting our rules to us and asking us why we didn't sit within our pronouncements. If that were so, perhaps it is not, I think it may be useful for your members to hear from the Executive as to what is in the research study of the Institute.

THE CHAIRMAN: This certainly would be your privilege, if you think it is useful and significant, to do so.

MR. TOWNSEND: Well, gentlemen, I think there are two important distinctions to be drawn here. One is that in the terms of the Institute, the official position on any matters of this kind the Accounting and Auditing and Research staff has been given the responsibility of seeing that the pronouncements, to which we have referred, found in the reasearch bulletins reflect the official position of the Committee. It gains its authority from the wide acceptance they have received in this country immediately upon its being issued.

In attempting to put forward at greater length, it is quite possible in most bulletins of the

Institute, controversial subjects which face the profession, the Committee on Auditing and Accounting Research authorizes a number of series of these certain studies, of which Professor Coutts' Oil and Gas Studies is one of the series.

The series themselves are designed deliberately to bring forth the pros and cons of any particular situation and to the extent that they do bring in conclusions at all, they are entirely the conslusions of the author concerned.

In this particular case it was a study group of 15 chartered accountants who live in Calgary and who are associated with the Oil and Gas industry, who formed the advisory panel.

The fact they were there, they were used by Professor Coutts to voice this thought and get further opinion and does not imply either agreement or disagreement either by that Committee with Professor Coutts' comments and conclusions any more than it does imply agreement or disagreement of the Committee on Accounting and Auditing Research.does.

If I may go on, one further point which Mr. Leach I think has covered but I think is important to be stressed that in any profession which is facing a great number of new developments -- the medical profession is probably the one closest parallel to the accounting profession -- in this area there has been a great deal of controversy and as new subjects are brought forward accounting has a need existing, the difficulty of delineating what are the accounting principles on which the accounting profession of any particular country is facing. This conclusion isn't only one which is facing Canada but which is facing the accounting profession in any country that has as highly developed and sophisticated business as does Canada, and in addition in this particular country we are assessing the pros and cons and of developing some sort of clear cut principles which up to now is in a state of flux. The Institute Committee on accounting and auditing research has set up a major project to look into it as the Americans and Australians and British have done, more clearly delineating those accounting principles which are acceptable to the majority of the accountants in this country. This project will run at least several years and in all probability there will be strong differences of opinion on what their conclusions may come out of the study.

MR. LITTLE: I think it is important, Mr. Chairman, to have that explanation of the nature of these studies on the record. If, before Mr. Stewart resumes his questioning, if I might summarize what our

position is in this regard which has been to measure the advantages of including the words such as this the Act, and we concede some benefits would flow, but we are greatly concerned that the disadvantages would outweigh these advantages primarily, I suppose, because as has been indicated the accounting principles and practices are not actually so codified that one can accept them for taxing statute, but our major concern really is that if we introduce those words into the Act and the courts themselves in a series of decisions over the years restrict and narrow the area with which they are dealing they over the years will come to delineate for us what are accepted accounting principles and practices on one hand and on the other we will find the taxpayer, our client, will have a tendency to direct himself towards the area of greatest tax advantage in his presentation of accounts without regard for what might or might not be practical from a business point of view. These two things taken together will have a restrictive effect on the profession's approach to a gradual evolution of what we think ought to be proper principles and practices. It is for this major reason that we say no to this proposal.

MR. STEWART: Now, gentlemen, I quite appreciate from both your submission and what you have just said that you are not in favour of this particular proposal, but I would like to explore it a bit further with you. You say on page 2 of Appendix C about half way down the page, you indicate in spite of certain

differences and uncertainties to which you have referred there you think the principles governing the determination of income for taxation and accounting should not be widely apart, and then if I go over to page 12 of the submission where you are dealing with the problem of reserves you say in paragraph 41 in general terms, and I hope I am not taking the words unduly out of context, you say the Committee believes that any reasonable charge against income acceptable for accounting purposes should be allowable for tax purposes. That seems to me to be about half of the battle as far as this particular proposition is concerned. Are we not in this position, if accounting income and taxation income should be governed by the same principles to a considerable extent, that if these words were incorporated in the legislation we would at least provide, we would formerly provide the Courts, the people who are responsible for incorporating the law with a guide post or sign post which, from what you say they ought to be using anyway. Are we not, if we put the words in, reducing uncertainty and are we doing more than what you are going to suggest should be done because whenever a particular case comes along you are going to be advocating that the Courts deal with that particular case according to generally accepted accounting principles.

MR. LITTLE: Mr. Chairman, might I ask counsel does he make any distinction between principles and practices? Is he using the words interchangeably or are you suggesting that we should use the words

generally accepted accounting principles in the Act? We have suggested there are two approaches to this. Might I ask which one you are pursuing?

MR. STEWART: I think that is a perfectly fair question. On page 2 of Appendic C you were referring to principles. On page 12 you were dealing with charges acceptable for accounting purposes. If there is any real distinction between principles and practices maybe we should define it. I would hate to think practice was unprincipled.

MR. LITTLE: I am sure we concur in that view, Mr. Counsel. Incidentally when you refer to us, you appreciate Appendix C is the Institute's Committee on Accounting and Auditing Research.

MR. STEWART: I assumed, Mr. Little, you had adopted it.

MR. LITTLE: We have adopted it. I think there is, of course, a very significant difference between principles and practices, although it doesn't necessarily follow the practice is improper simply because there is uncertainty as to the principle followed.

THE CHAIRMAN: Would you be in a position to bridge both words by speaking about good accounting without going into principles or practice. I have always stumbled over those words and I think I mean the same thing when I say good accounting.

MR. LITTLE: I think that is a very successful approach to it, Mr. Chairman. If we reach that point surely it is unnecessary because it would be

unthinkable one would produce either annual statements or tax returns adopting bad accounting. I am not sure, Mr. Counsel, just exactly what you wish to draw from us. There is no question that in any approach to the determination of income, whether it be for shareholders, or for the national revenue there must be a technique adopted. The kind of technique is accounting. There are certain obvious guide lines that one follows in preparing his own accounts or the accounts for someone else. I think what is bothering us is the significance and the rigidity of words such as "accounting principles". As Mr. Leach has said there is not a broad well defined area of principles that one would come up because of further evolution of accounting practice due to changing matters. Our concern is that if we make statutory law of the principles and surround them with jurisprudence that we have restricted ourselves and lost flexibility of change and development in that respect.

MR. STEWART: I think what I am putting to you is this practice is probably going to go on anyway whether the words are in the Statute or not. In other words cases such as, for example, the Anaconda case are going to incur. I know among the profession, a part of it consider that case was wrongly decided and that it has had an unfortunate affect on the whole question of inventory evaluation for tax purposes in Canada. This could very well be so. The Anaconda case, I don't think would have been decided any differently, or perhaps it would, if the Statute as it was then in force had said that income has to be

determined according to generally accepted accounting principles or practices, whichever you like. The Anaconda case may or may not have been decided differently. From the point of view of your profession and the principles of accounting, surely those words couldn't have any, surely if those words had been included in the Statute it couldn't have had an adverse effect upon the decision.

MR. SIMONTON: Might I interject here, Mr. Chairman, counsel. If these words had been in the Act when the Anaconda case was heard and the courts had ruled against the use of the LIFO nothing that might have tended to suggest that LIFO wasn't an acceptable accounting procedure because, in fact, the courts may have been ruling directly on whether LIFO was or wasn't a generally accepted accounting practice. One could judge possibly that in those circumstances there would have been a very good possibility that with the phrase "generally accepted accounting principles" in the Income Tax Act, that the decision would likely have accepted that accounting treatment.

THE CHAIRMAN: Could I interrupt, Mr. Stewart, just a minute. I seem to remember that LIFO case better than some of you gentlemen. I recall very clearly in the judgment of the Privy Council it was clearly stated whereas this was a good method possibly for business purposes, and that the Judge had no quarrel with it for business purposes whatsoever, it is only when it is used to measure income for taxation that he was concerned. It seems to me he drew a very clear distinction and that

that distinction, I wouldn't think could have been drawn if the law prescribed that income was to be determined in accordance with accounting methods, principles or practice.

MR. LITTLE: You will also recall, and this is just for the Commission members that that particular case was won by the taxpayer in every court in Canada.

MR. LEACH: I think we should say we are still apprehensive that some court might go off on some unpredictable uncertain course and it would, it is suggested notwithstanding the words they might decide otherwise than on a basis of jurisprudence. Mr. Stewart's original question was whether this would be helpful. Of course, it would be helpful in many areas. I think we have painfully come to the conclusion that the dangers and disadvantages would overcome whatever help there would be.

MR. STEWART: Let me ask you this: In the past the courts when they have been dealing with problems which as you suggested ought to be governed by accepted accounting principles or practices, the courts have had to determine what those, what good accounting requires, to use the Chairman's expression with the assistance of expert witnesses. If we get to the point in taxation in this country where it is not sufficient, if accounting practices become of such importance in taxation cases that the court should have the benefit of accounting assessors or advisors, call them what you will, or the benefit of the advice from panels of accountants as to what accounting principles dictate

when they are applied to a particular problem which is under review.

MR. LITTLE: Well, surely, Mr. Counsel, whether the words are in the Act or not the court must reach the conclusion as to whether or not the particular accounting technique adopted is appropriate in the circumstances. The mere fact that you include in the Act the suggestion that income must be determined in accordance with generally accepted accounting practices seems to me does nothing to relieve that problem. Surely the court must then go to the professional advisors and ascertain from them whether or not this is accepted accounting practice in a certain case. They surely will not rely on the taxpayer simply because he was guided by a Statute that includes the words. They must determine in the end result whether or not in the opinion of the court this particular practice is an accepted accounting practice and they can only determine this, presumably, by going to the professional experts who can tell him if this is so.

MR. STEWART: Yes, but Mr. Little, I perhaps haven't made my point. The only way the unfortunate member of the legal profession who is the judge has of determining what is the appropriate accounting practice at the moment is by listening to expert witnesses of both sides in the stand for what is bound to be a somewhat limited period. He has no one to whom he can turn once the hearing is over for advice on accounting matters. Theoretically he can read, but

it is very often the case, I think, that the available literature doesn't deal with the subject adequately for the laymen, or the comparative layman. Now, I am asking whether it would be useful in taxation cases to consider the appointment of someone to advise the Court alone, or a panel of experts to which any judge could go for advice on accounting practice and procedures and principles.

MR. LITTLE: I must say I didn't appreciate the second question which you have asked. The introduction of the words in the Act have no bearing on this question at all. I think I must agree with that. I think if there were such a panel this would be -- I assume there is such a panel, the Canadian Institute of Chartered Accountants.

MR. LEACH: In fact, judges sometimes do that, both officially and unofficially. This would I think be a means of encouraging sound advice.

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MR. STEWART: Would you consider that it would be desirable, again having regard to the importance of accounting principles and practices, to set up a separate kind of Board or Tribunal, composed of a accountants, to which appeals from the Departmental rulings or assessments on matters involving accounting procedures and practices may be referred.

MR. LITTLE: No. My personal reaction is that this would be wrong. It seems to me accounting principles and practices are developed by the profession and are adopted by the Institute. If you are to hive off a separate group which is to advise the court, let us say, what in their view is accepted accounting principles and the court will then adopt, it is wrong.

MR. STEWART: Suppose we are talking now about not a body which is going to advise the court but a Board of Review composed of accountants who are going to decide certain questions on appeal from decisions or assessments of the tax authorities.

MR. LEACH: This would be similar to what they call legal commissioners in England.

MR. STEWART: To some extent.

MR. LITTLE: It seems to me this is getting away from the accountant profession. This is a question of fairness, logic, reasonableness, interpretation of the law.

MR. STEWART: I am thinking, Mr. Little, of a case where the Department may have taken a view as to what the effect of applying recognized accounting principles to a particular problem is and the taxpayer

might have a different view so that there is a conflict of accounting opinion. at the moment the only way that can be resolved is through recourse to the court. I am just raising the question because it seems to me related to the basic problem that we are discussing. Would it be preferable to have a Board composed of accountants who could decide questions of that character?

THE CHAIRMAN: May I interject, Mr. Stewart, just to see where your line of questioning is taking us. I think I understand it.

Your point is, I believe, if we are not to be guided by any reference to accounting in the law, there must be then some means of producing a measurement of income in accordance with accounting in the future or else we may be measuring it by economic or other standards rather than accounting standards and if we are not to use accountingin the context of the Act, therefore there should be a Board which would administer accounting.

MR. STEWART: Well, that is one way of putting it, Mr. Chairman. I have approached it this way:

There are going to be many questions, I suppose, inventory evaluation is one, where there may be dispute between the taxpayers and the Department as to how the cost of inventory is properly to be determined. At the moment that type of dispute ultimately finds its way to the courts for decision. I am wondering whether where there is a pure question of what proper accounting is, the dispute should go, not to the courts, but to a separate or special body of

review composed of accountants.

MR. LITTLE: Well, it seems to me if in such a case the Crown would agree to refer to the Canadian Institute of Chartered Accountants, there is a Committee that would appropriately rule on it. It would seem to me wrong that any group, other than the Institute, would be set up to make pronouncements on accounting policies and practices and what is right in any particular circumstance. This is a professional matter and one does not hive off on some other Committee outside the body.

I would, and I am sure you would in your own industry, resist very strongly hiving off all of these decisions to some other independent group, which is not under your control.

Perhaps, Mr. Chairman, if we appear to be adamant on this point and obstructive to the Commissions probing, I should go back to my opening remarks and say we were not by any means unanamous on every point. We explored both sides and this is also true, I might say, the Institute Committee on Accounting and Research was not a unanamous view but was a majority view. It might be useful to bring out points that you seek to develop if we are to speak to the other side of the matter.

Mr. Kelsey and Mr. Townsend in particular I am sure, are finding it very uncomfortable sitting here at the moment keeping silent.

THE CHAIRMAN: I think we are making good progress. It seems to me Mr. Stewart has raised

a pretty valid matter here and you have given a very clear reply and it is a reply which I can understand. I think I know the reason for it.

COMMISSIONER GRANT: Mr. Chairman, I have one short observation on this duscussion. I would like to ask Mr. Stewart what emphasis he would give to the principle of interpretation of statutes, that is, when a case gets before the court such as the Anaconda case where a principle, I believe, on taxation interpretation of taxing statutes is that it must be strictly construed. If the term "accounting practices or accounting principles" were included in the Act in this particular case, then the court would have been bound to inquire further into what was and satisfied itself as to what was accounting practices and be guided in their decisions by the evidence that would be produced.

THE CHAIRMAN: You are referring to the Anaconda case?

COMMISSIONER GRANT: Yes.

MR. STEWART: Mr. Chairman, I don't know that I can give a very satisfactory answer to Mr. Grant's question. I do not know how the Privy Council would have decided the Anaconda case if these words had been included in the Act at the time.

COMMISSIONER GRANT: I am thinking of it more of applying your concept of law to that.

MR. STEWART: My concern, Mr. Grant, is this: That as these gentlemen have said, we are dealing with a society which is increasingly complex and developing in many fields in quite remarkable ways.

Now, what we are all, I know, concerned with is developing a system under which we can get the best possible answer on these questions of taxation when there are appeals from the Departmental assessments.

I have some concern as to the adequacy of our present procedures, this is a personal concern. I think that the accounting and legal professions work together and as best they can in the present framework to produce satisfactory results through the Courts but I have some queries in my own mind as to the ability of the ordinary court to deal satisfactorily with the technical accounting questions which may now come up.

That is really why I got to this particular line of questioning.

COMMISSIONER GRANT: Just one final word on that and that is in the absence of the words in the statute, the court may very well feel that it was fully competent within itself to determine the law, whereas if the words were in the statute then it might be that they would feel bound to follow the expert advice.

MR. STEWART: Well, I think that the point which has already been made is quite valid, that it would be most unfortunate if the courts made a ruling that there was a particular accounting principle could imply and does imply for all purposes and not simply for tax purposes or for the purposes of the particular case it was dealing with.

I can quite concede this would have an inhibiting effect on the development of accounting principles but what the solution to that is, I do not know.

I think when we have legal decisions now which appear to have been wrong or to not reflect the modern development position, we can revert the legal decisions by passing a statute. I don't know if you can change a principle by passing a statute for the purposes of the accounting profession.

Well now, gentlemen, I think that it may be that there is a real question here where the advantages of including words of this sort in the legislation do not outweight the disadvantages which you have in mind.

I would like to pass to a slightly different point, but one which I think is related. Again looking at it Appendix C --

MR. LITTLE: Mr. Chairman, just as we are turning the pages, I shouldn't like to leave that comment on the record in case posterity might think there was any question on our mind as to whether the advantages outweigh the disadvantages. This is a conclusion which perhaps your counsel has reached with which we do not agree.

We are opposed to the introduction of these words and our submission is that, the disadvantages outweight the advantages. There is no question.

THE CHAIRMAN: I understand, thank you.

MR. STEWART: Now, if we can look at page 3 of Appendix C, you indicate that one of the consequences which might follow from the incorporation of such words in the statute would result in considerable difficulty and uncertainty. I am looking at paragraph 7 on page 3. You indicate that there would be then a

demand for an enactment of specific sections to clarify areas of uncertainty. Then you say at the bottom of that same page that any advantage from the change would be more than offset by the difficulties in its application and the potential dangers to the future development of the accounting art, and you say that in your view improvement in the Act must come from a careful and detailed redrafting of the Act and that those responsible for drafting the laws keep in view the overriding objectives of fair and workable determination of taxable income.

Now, does this mean that you consider that in general our legislation should be detailed in the sense it deals with each problem which is likely to arise in a specific way and that the Act cannot effectively set out general principles and leave the application of its principles to practice and the courts.

MR. LITTLE: I think, Mr. Chairman, that this sentence really stems from the terms of reference that we had submitted to the Accounting and Auditing Research Committee.

The whole concern here was that possibly the inclusion of these words might be a way of improving the Act and solving the taxpayers' problems, removing uncertainties and so on and it was in part, in this context, perhaps improperly, that we put the question to this special committee and in coming to the conclusion that this was not going to help solve the problems in the Act they went on to suggest that some other approach might be taken. In their view redrafting was necessary.

I do not think it would be fair to suggest that our Committee feels that you could legislate every particular circumstance but the real problem in our Act has come from exemption, seeking out of special areas for taxation, the taxing of specific transactions, in trying to surround them with legislation that lets everything else follow some other form of taxes.

It seems to me when you have this problem, when you have the exemption problem, when you have different terms for different industries, different taxpayers or different areas geographically, this is what gives rise to the problem in the Act.

I think that it is likely what the Committee of Accounting and Auditing Research had in mind was simplification of the Act, plus certainty which would do more than the introduction of these words.

Perhaps Campbell Leach, you would like to amplify that? It seems to me that is what we had in mind.

MR. LEACH: Mr. Chairman, I think Mr. Little has put it very well. I would suggest this can be taken to mean that the present anomalies should be removed and in future great pains should be taken to prevent further ones creeping in.

There is much material on that in the rest of our brief.

THE CHAIRMAN: In those words you are moving on to the control of and determination of, profits, are you not? When you are talking about exemptions and

various sections that would probably creep in, which are deductions in relation to the income; income being arrived at from profits.

MR. LEACH: Well, not necessarily exemptions, Mr. Chairman. You will see pretty soon we are talking about reserve sections. If they can be related and can be improved. You see, there are many examples.

THE CHAIRMAN: Right.

MR. STEWART: It seems to me that, when we get to the reserve section and sections dealing with a number of other points, you deal with them specifically as we go along.

You are advocating that the Act should be amended on that specific matter to accord with what you regard as accepted accounting principles or good accounting and yet we find ourselves in what seems to me to be a somewhat anomalous position that you do not want a general statement in the Act that income/be determined according to good accounting.

MR. STEWART: However I think we have, perhaps, exhausted that particular point.

MR. MCMACKIM: Mr. Chairman, if I might say a word, I think you have to differentiate between accounting principles or practices which have become well established and almost universally recognized on the one hand and on the other principles and practices of accounting, accounting principles and practices which haven't reached that stage and which are a matter of argument and difference of opinion among equally eminent members of the profession. If you introduced the words generally accepted accounting principles into the Act I presume it is to be read as though you said, in fact, generally accepted accounting principles -- I won't say practices, just for brevity -- generally accepted accounting principles as applied to all matters of an accounting nature. It seems to me that is where the difficulty is. The things we dealt with specifically on page 11 and following, with the possible exception of LIFO there is, I believe, little or no dispute amongst accountants as to what is sound accounting practice. It is surely a very different thing to talk about the generally accepted accounting principles as applied to every conceivable problem that could arise in accounting. I would add too I think accounting is and must always be to some extent a matter of opinion. To that extent, to some degree it is art and not an exact science and it can or must be ~~through~~ free to adapt and change itself as it has been to change itself in the

industrial and economic life of our country. The principle point I would make, a clear distinction between recognized and almost universally accepted principles and attempting to apply that general approach to every conceivable situation.

MR. STEWART: Thank you very much. Well now, again in Appendix C you suggest, and I am now looking at page 2 of Appendix C and in numbered paragraph 3 on that page you indicate that the Statute will provide for specific departure from recognized accounting practices to facilitate the administration of the Act for the purposes of equity and to provide special incentives. That seems to support the proposition that I suggested earlier that we have at least three types of income. We have this real or economic income. We have accounting income and we have tax income. I observe that in a speech he made at the 1962 conference of the Canadian Tax Foundation Mr. Townsend, who is here, put it this way. He said at page 355:

> "It becomes apparent, then, that what has been referred to as tax income is not, in any sense, income at all, but merely an amount which is to form the base for levying taxes."

Then he proceeds to indicate that in the balance of what he had to say he was going to differentiate as clearly as he could between these two, the one accounting income and the other tax income.

MR. LITTLE: Mr. Chairman -- I am sorry, you weren't finished.

MR. STEWART: I was simply going to ask for comments.

MR. LITTLE: Before Mr. Townsend comments might I in turn ask a question. I think there is no doubt in any of our minds that there is a very great difference, no doubt, between the amount that is subject to tax and the amount that is accounting income. You said in your question there are three forms of income, real or economic income, accounting income and income subject to tax. Would you are to delineate to us what is your concept of economic income as opposed to accounting income before we reply to the question?

MR. STEWART: I would go back, Mr. Little, in that regard to what Professor Coutts said and what I referred to earlier. He said the one differed from the other in two essential respects. If I can remind you he said this:

"There are two real differences, the first arises from the accounting practice of measuring values successfully in terms of money so that increases or decreases arising from changes in the value of money itself are not distinct from those which represent real changes in relative values. The second source of difference

arises from the accounting practice of ignoring changes in value until they are realized by sale or exchange for money or monies worth".

Like yourself I am not an economist. I simply take those words.

MR. LITTLE: There is no suggestion that we should be turning our attention today to whether or not we should account for changes in the real value or unrealized depreciation or this sort of thing. We make a distinction between accounting income and taxable income for the purpose of our discussion. I think we must because I don't think that we have an expert here who could deal with the other problem.

MR. STEWART: I would like at a later stage to ask some questions about accounting for changes in value.

MR. LITTLE: Right.

MR. STEWART: Beyond that we don't need to go.

MR. LITTLE: We have reached the conclusion then.

MR. STEWART: What I am trying to bring out here, and you must consider it self-evident that when we talk about income we are talking about something which means different things to different people, different things in different contexts. I have found three approaches to income. I think from what you have said there is no doubt here in anybody's

mind that accounting income and income for tax purposes are quite different. Is that correct?

MR. LITTLE: That is right.

THE CHAIRMAN: Would you like to stop at this point, Mr. Stewart and break for ten minutes.

---A short recess.

THE CHAIRMAN: Mr. Stewart, I think we may commence.

MR. LITTLE: Might I interrupt Mr. Stewart. It seems to us in chatting during the intermission that we are fearful of appearing to your Commission as being adamant or one sided on this terribly important question. While there is no question in our mind as to the propriety of the decision we have reached it is true that there is a very strong argument, very compelling argument on the other side. I think if you would permit us I think we would like to have those members of the committee who share this other view to speak up to them because, if nothing else, it may provide your Commission with the point-of-view that has been put forward by another group. This is not a suggestion of dissention between us, but merely to bring out all the facts we have examined and analyzed in coming to the final conclusion we have reached. If this wouldn't prolong your hearing unduly I think it would be useful to hear from Mr. Kelsey and Mr. Townsend.

THE CHAIRMAN: There is no more important matter we are going to deal with and certainly we would be very glad to hear it, in fact, I believe it would be

extremely helpful.

MR. LITTLE: I think perhaps Mr. Denton Kelsey might take the other side.

COMMISSIONER BEAUVAIS: This decision was made on the 80, 20 basis?

MR. LITTLE: That is right.

MR. KELSEY: Mr. Chairman, it is not so much we have dissented. I think we have all been torn in this issue. One of the difficulties stems from this question of what principles are. In the natural sense one can look for some underlying truth, and if one looks long enough one might hope to find the perhaps hidden harmony that is regulating the happenings of all things. This isn't so in our work, in our art. We can look for no underlying truths that need only be sought out and we have the answers. What we have to do is grapple with problems day and day and arrive at practical answers in determining the income. We can't search and find out that there is some fundamental principle that says income shall be determined in this fashion or that fashion. With deference to the members of the law I suggest this is true also there. There is no fundamental body of philosophy that governs how lawyers are going to determine income for purposes of taxing it.

MR. STEWART: I think the legal profession would agree with that completely.

MR. KELSEY: We, therefore, are dealing with something that is founded on artificial concepts. It is a useful thing but it is an evolving thing that

has been changed by us and by lawyers as we go along to serve best the needs of business and the community as they have been shown to us. We therefore, both of us, taxing people and accountants, seek to arrive at something, we call it income, which is an artificial thing and it didn't seem to us universally a pity we might by going down separate roads entirely, that might somehow be merged together or have some link so that income as an accountant thinks of it had some relation, some link with income as a tax man thought about it. As one of us said the determination of income is one of the most important functions of our profession. It appears to us in the interest of everyone concerned that income means the same thing to as many people as possible. Surely the importance of income determination will be increased if the same rules for determination are used for other purposes as well.

What concerns us, and really I think the fundamental point that has led to the recommendation in our brief, enshrining in of tax statutes some direction that the law must recognize these accounting principles with a fear that doing so would tend to stress, solidify the evolution of our determination of income, which as I suggested earlier is something we wouldn't want, we wouldn't feel free to adapt readily to meeting the changing needs of the business community. We consider if these principles, these rules which are equally changing do become solidified by embodying a lot of juris-prudence which governs laws we would lose our flexibility and some of our

ability to serve the business community. We did wonder, some of us, whether there might be a way of achieving a measure of agreement, or, at least reflecting the extent to which these two bodies diverge, and we wondered if this might be done in an indirect way by having some direction in the Statute along these lines: income for taxation or for business or profit as provided therefrom shall be determined subject to the other provisions of this part in a manner which is not inconsistent with the application of generally accepted accounting principles. It seems to some of us these words would recognize generally accepted accounting principles and in some circumstances permit the wide range of income to be determined. It would at least keep the range within those principles, and therefore remove the possibility of income determined for tax purposes to be more and more determined not diverse from income as accounting sees it.

I don't think this is really in conflict with the view of the committee. We are in the most united behind the belief that a solidification of this in the Income Tax Act might endanger the development of our art. Nevertheless I think we are all conscious of the undesirable results of income from the point of view the tax gatherer departing too far from income as the accountant sees it. I think that is all I have to say. You may wish to add something to that?

MR. TOWNSEND: I don't think so.

THE CHAIRMAN: Thank you ineed, Mr. Kelsey,

that is a very fair statement. I think, Mr. Stewart, we should probably understand fully the area of departure of the minority group from the general recommendation, and I think perhaps as I would see it this refers to accounting, even though it is a very prescribed reference to accounting. You, Mr. Kelsey, would bring into the Act some mention of accounting even though, as I see it, it doesn't go the full distance, but it does, at least, I think you indicated try to get the measurement of the profits on accounting measures rather than other measures. It would essentially be accounting measures. I think that is the point you make. Am I right? That is the point where you depart from the majority view?

MR. KELSEY: I think that is correct, Mr. Chairman.

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I take the view that these are artificial things and surely it will serve the community and our society better to have a limited -- as few of these artificial things as possible.

If we could somehow bring together the accountant with the tax gatherer it perhaps will advance together for a better understanding of what we are searching for.

THE CHAIRMAN: Thank you very much.

MR. TOWNSEND: I think, Mr. Chairman, in determining income for tax purposes that first of all you look at the income according to commercial and accounting practices and having done that, the provisions of the Act are applied.

I think the minority view in the thinking was just to recognize in the statute what was being done in practice at the present time would be the only way to bring some clarity to the statute and some more certainty.

In certain cases we did feel that if those words were put into section 4 that there are some sections of the Act that could perhaps be dispensed with. I am thinking of some parts of the reserve section, the inventory section, this type of thing, recognizing, or course, that there has to be sections to protect the revenue in some cases.

Just to touch on the paper that Mr. Stewart mentioned, I do feel that a great deal of time has been spent in the past in discussing the legal versus the accounting income; accounting income versus

tax income, etc., which, when one thinks of the different meaning of income -- If one could get away from thinking that income for tax purposes had really nothing to do with income in the sense of using income or income for tax purposes is something that you arrive at by provisions of the Act and income for accounting purposes in the first place.

So often, all these discussions have been trying to think of income as being the end result from the legal sense, and the end result from the accounting sense, so this is why I put forward this proposal in the paper to indicate the difference between income and democni.

Going back to our Chariman's comments I suggest that there be a panel of experts, Mr. Chairman, I think he is quite right when he points out that it would not be good to have a body apart from the CICA which would say where generally accepted accounting practices applies in a particular case, but I do feel and I did feel, that it would be possible to have a panel of experts which would advise the court on generally accepted accounting practices. Those experts would be nominated by the CICA and in this way not be in fact, a separate body without any control of the personnel on that body by the Institute.

THE CHAIRMAN: Good.

MR. LITTLE: Mr. Chairman, I think I should say at this point from the earliest work we have prided ourselves on the objectivity of our approach. We have no particular axe to grind.

Suddenly it has dawned on me that what we are really struggling for here with this proposal, while there may be some advantages in the Act, we see disadvantages in the Act.

What really concerns us most is the effect on the development of our profession so we are not --

THE CHAIRMAN: Is the effect of what?

MR. LITTLE: The effect on our profession; the inflexibility that might be introduced if, on the one hand, we have taxpayers trying to follow the most favourable taxing basis by adopting certain standards and also the rigidity which would be introduced into the profession and so change its practice and principles.

We must confess that we do have a particular point of view for our own profession here which we are assiduously trying to guard as well as the problem of the tax statute per se.

I think on balance that forgetting our own interest, we would still conclude that while there are advantages we can see from introducing the words, we think that the uncertainty it might create in other areas of the Act was perhaps counterbalanced.

MR. McMACKIN: Mr. Chairman, I don't believe that, with all respect to our chairman, that our concern for the profession has been a selfish one. I think we have been motivated here in this particular problem with the greatest concern about something that would greatly hinder our profession in giving its best and what it should be able to give to the business

community. Surely this is not a selfish approach.

THE CHAIRMAN: No, I think we are all taking this to mean that your concern is a concern with the observation of good accounting and not for the purpose of the benefit of the profession but for the benefit of the community. Certainly that is what I assume.

MR. STEWART: Well now, Mr. Chairman, I would like to go, if I may, to certain differences between income for tax purpose and income for accounting purposes. I observe that in the portion of this brief which deals with capital cost allowances, reference is made to the question of whether reporting in financial statements should be on the basis of current dollar values rather than on the basis of actual costs.

In paragraph 106, which is on page 36, the Committee refers to that question and indicates that it doesnot consider that this accounting technique is sufficiently well developed or accepted as yet to warrant recommendation to depart from the use of cost as the basis for calculating capital cost allowances.

THE CHAIRMAN: Mr. Stewart, are you reading the chapter entirely?

MR. STEWART: No. I am right in the middle of it.

I notice that there was a reference to current dollar accounting.

MR. LITTLE: Yes.

MR. STEWART: On this particular point, I wanted to ask if there is a prevailing view in your

profession as to whether current dollar accounting, if that is the proper expression, is likely to become accepted or widely accepted? My next question is going to be and perhaps I should indicate why I am asking these first; if it were to be accepted for accounting purposes, would you feel, in your opinion, that it should be reflected in tax legislation or reflected in income for tax purposes.

MR. LITTLE: Mr. Chairman, I don't think that in assessing this problem we turned our attention to the likelihood of it becoming an accepted accounting basis in the near term or far term. I think we are simply dismissing it because it wasn't with us yet.

I would imagine that if each of us spoke in turn on that question we would have quite a diversification of approach. My own thought, for what it is worth, is that this technique, even for accounting purposes, is probably fairly well in the future still.

I don't really think, Mr. Stewart, that we should conjecture at this point as to whether or not it would become a general term or whether it should also be adopted for tax purposes or not. We certainly have not considered it in that light.

MR. STEWART: Thank you very much. Let me go on to the question of capital gains. Is it now a fact that capital gains or losses are ordinarily included or reflected in the profit and loss account when you are preparing such accounts for ordinary corporate purposes?

MR. LITTLE: Well, I think that one first must delve into the realm of significance because it is true, I think, and generally accepted that an item which is not significant in relation to the other items in the income statement, should be included there even though it is a non-recurring or of a capital nature and not an ordinary trading item.

But, I think, in this country, that a very significant capital gain would either be shown in the surplus account or if shown in a trading account, would be shown as a separate item and would clearly stand out so an intelligent reader would recognize this as something that was not a trading item.

The same thing is true of capital losses. I think probably in the area of capital gains and losses in respect of capital equipment that the whole problem has been somewhat obscured by our capital cost allowances system for tax purposes because in this connection, as you know, what actually is capital loss would be left in the account and amortized over the future years and not recognized, so there is a great area there.

I think items of real significance in relation to the statements per se would be recognized either in a special fashion or would be so earmarked and noted one could appreciate what was going on.

MR. STEWART: Well, then, if we are to be concerned with the computation or determination of business income for tax purposes, what would you say as to the propriety of including capital gains in that

income.

MR. LITTLE: Well, Mr. Stewart, I am not quite sure whether you are asking me whether we think it is right that what might normally be considered merely a gain on a piece of equipment ought to be taxed as it is under our present legislation or whether you are turning our attention to taxing the whole area of capital gains as such.

MR. STEWART: I am in between those two. I am not talking solely about equipment. I am talking about capital gains realized by business.

MR. LITTLE: Well, I think that in our deliberations we have assumed that we devoted our attentions to the taxing of income. We are not taxing capital. One could conclude very readily from that that the answer to your question is that we were not thinking of capital gains and in the strict sense ought not to be taxed. Naturally one would qualify that if one is in the business of realizing capital gains, that is quite a new matter.

MR. STEWART: If one is in the business of realizing capital gains. Well then, do they not cease to be capital gains?

MR. LITTLE: I think that is the law.

MR. STEWART: I am afraid it is.

How significant do you consider it to be that income for tax purposes is income for a particular fiscal period or taxation period; whereas income for corporate purposes may be related to a longer period, whatever it is, the whole life of the corporate taxpayer

or some shorter period? Is this in your opinion a basic distinction between accounting income and income for tax purposes?

MR. LITTLE: I think, yes. I think that the Act now recognizes this. This is something of which our Committee approves. In fact, we extend this principle because it is perfectly true that a 12 months period per se may have no particular significance in the economic life of a particular business or transaction, but it is, we think, desirable both for the purposes of periodic reporting to the proprietors on the one hand and also from the point of view of the country in realizing revenue. There must be some period of accounting but we think that it is right that loss-carried-forward provisions, for example, have been introduced into the Act to alleviate the problem that is faced by companies whose business fluxuates in the 12 months period.

As you will see in our recommendations we have suggested an extension of the carried-forward period, instead of one year, we suggest three with a 5-year carry-forward period with this provision that we accept the periodic 12 months accounting period as acceptable for tax purposes.

MR. STEWART: Now, may I ask you this with regard to one specific type of problem. When it comes to distinction between repairs allowed as a current expense and capital additions, is this an area where difficulties arise in the computation of income for tax purposes? Secondly, if it is such an area, would

these difficulties be resolved if it were provided that the question of any particular cost should be determined according to accepted accounting principles or good accounting?

MR. LITTLE: Well, to divide the question into parts. First of all, it is a problem area. There is no question about that. This arises largely from two things; the anxiety of the taxpayer to be conservative and prudent and to amortize his expenditures as rapidly as possible and sometimes perhaps he is over-diligent in this respect. It also arises because of differences in approach we have between the taxpayer and the revenue.

I think this is perhaps something we did not really touch on in the brief. I don't know that we hinted at it except in a brief sort of way but we do think, many of us, that in this area the Department of National Revenue attempts to reap the greatest amount of current revenues by taking a narrow approach to capital versus income type expenditure.

I am sure that all of us have had circumstances where we have felt that the Revenue had departed from what we would have thought would be a solid accounting practice.

To turn to the second part of the question, I personally do not see how this would help in any respect by the introduction of these particular words in the Act. The problem is with us now.

MR. LITTLE: Both the accounting practitioners and the Department of National Revenue presumably are trying to adopt some relativeness in the determination of income. It is simply a question of difference of rules. This particular chapter and the whole area of capital cost allowance is one that Mr. Garneau -- I beg your pardon, my expert is not here.

THE CHAIRMAN: I am not sure we have moved to this area yet.

MR. STEWART: No, Mr. Chairman.

THE CHAIRMAN: This line of questioning reverted to Chapter 2.

MR. STEWART: I was simply dealing with areas where there might be a difference between accounting income and income for tax purposes.

MR. LITTLE: To put it into chapter 2 our conclusion is you wouldn't improve that particular situation by the introduction of this clause.

MR. STEWART: Let me come to the question of the LIFO method of inventory valuation which you deal with on page 11. I observe at the end of paragraph 38 on that page you say:

> "It is a generally accepted accounting practice that, in certain circumstances, LIFO is an accepted basis for establishing the cost of an inventory".

I have got a number of specific questions on that. In those circumstances where you say it is the generally

accepted accounting practice would it be the only accepted accounting practice?

MR. LITTLE: No.

MR. STEWART: Could you say whether LIFO is used for corporate purposes to any extent in Canada?

MR. LITTLE: Yes, it is used in Canada. I have had difficulty in assessing the extent in relation to the number of companies. I am sure that each of us could speak to that, Mr. Stewart. Two of my clients, for example, do adopt this method.

MR. STEWART: Then, you make reference to Bulletin No. 5 of your Institute that says with regard to LIFO:

> "The method selected for determining cost should be the one which results in the fairest matching of costs against revenues regardless of whether or not the method corresponds to the physical flow of goods".

Then it goes on:

> "If the selling prices of the finished product varies concurrently with the price of the raw material the LIFO method of cost determination may be appropriate even though the goods first received are those first disposed of."

That I take it is an example of circumstances in which LIFO was considered to be appropriate.

MR. LITTLE: That is one circumstance.

MR. STEWART: Now, the Bulletin doesn't appear apart from that to indicate in what circumstances it would be appropriate. Do I take it that on page 11 you are limiting the cases in which you think it would be appropriate.

MR. LITTLE: Yes, definitely.

MR. STEWART: Well then, I think, Mr. Little it has been suggested that if LIFO is adopted even in the circumstances to which you refer that it may produce the result that inventories are carried at a level far below replacement cost.

MR. LITTLE: Yes, that could follow.

MR. STEWART: We have already referred to the Anaconda case, and I would like to read three comparatively short extracts from that case, from the reasons for judgment of the Privy Council in that case.

The first is this:

"Their Lordships do not question that the LIFO method or some varient of it may be appropriate for the corporate purposes of a trading company. Business men and their accountant advisors must have in mind not only the fiscal year with which alone the Minister is concerned. It may

well be prudent for them to carry in their books stock valued at a figure which represents neither market value nor its actual cost, but the lower cost at which similar stock was bought long ago. A hidden reserve is thus created which may be of use in future years. But the Income Tax Act is not in the year 1947 concerned with the years 1948 or 1949: by that time the company may have gone out of existence and its assets have been distributed."

Then there is another section:

"Again, though their Lordships recognize that this appeal must be determined by reference to the Canadian law, they notice that in the U.S.A. in a case in which the so-called "base stock" method was under discussion Mr. Justice Brandeis used words which are apt to describe the LIFO method also."

In years of rising prices the "base stock" method causes an understatement of income: for it disregards the gains actually realized through liquidation of low priced

stock on a high price market. This method may like many reserves which businessmen set up in their books for their own purpose serve to equalize the results of operations during a series of years..."

The third and last quotation I would like to read is this:

> "An expert witness called for the company observed that he did not imagine any of the company's witnesses would claim for a minute that there was a quantity of metal then on hand acquired in the year 1936 equal to the quantity which was valued at the then cost. Yet there was no less than 6½ pounds of copper in the 1947 closing inventory to which the 1936 cost was ascribed. He might have added that year by year the same thing would happen so long as the business went on and existing stocks were not seriously diminished. In 1987 as in 1947 the closing inventory would carry stock to which 1936 costs would be ascribed. This illustrates clearly the LIFO method and shows how far it has travelled from the conception which

prevailed in the assessment
of income for tax purposes."

It seems to me here we are, perhaps, faced with the question of timing we have already touched upon. It appears that for accounting purposes one must probably look at a longer period than the particular taxation year. For tax purposes the emphasis may be somewhat different. I wonder if you would care to comment in that context on the Anaconda judgment and in particular the extract I have read from it.

MR. LITTLE: Well, I would suggest that in the case of the last carry forward and back provisions the adoption of LIFO is one further factor that tends to alleviate the problem of measuring income in the short cycle. I think that there is no question that the LIFO method of costing differs from the other ordinary recognized basis of costing which might be the 1st in method or the average cost or some sort of standard cost, which methods are endeavouring to attach actual disbursement dollars to a particular item. This is, in fact, a completely different approach to the determination of income. It is really an income concept rather than a costing concept because it is attempting to match the current proceeds on sales with what one must lay out today to acquire merchandise for sale. The effect it would have on the stock is incidental. You don't sell stock unless you go out of business. If you sell it you replace it. I quite agree from a legal point of view, perhaps the LIFO method does turn up with a determination of cost which is completely

different and foreign to ordinary thinking and one can only accept it by linking the whole concept to proper determination of income. If the price of the end product rises much it rises because of the price of raw materials today rises. You make your sales, you make your replacement today and the income you really reap is that particular spread. The fact you use olded merchandise in this concept is incidental. I think we must accept and recognize the fact that when you adopt the LIFO method we are trying to adopt a successful approach to the determination of income rather than trying to ascribe to the particular outlays of dollar costs something that happens to be in the warehouse. I think I really should turn this discussion over to Mr. Leach who is anxious to apeak on that subject.

MR. LEACH: I was a little restless because I wanted to refer to the quotation from the Judgment of Chief Justice Brandeis which was dealing with the base stock method which is the predecessor to LIFO. Something that I noticed is absent from the quotation, the very thing Mr. Little is saying the direct relationship between your material price and the finished goods. Consequently this is the thing you must always have. We are thinking about selling price. You have, in fact, realized a selling price sufficient to pay for the goods that you are buying concurrently. This is justification for holding back the lower price goods until you reach, perhaps, a decline in price where they can be picked up, matching costs against income.

MR. STEWART: Mr. Leach, we are dealing with

this limited type of thing at the moment, but I grant you Mr. Justice Brandeis may not have been dealing with this limited type because the case he was dealing with is a steel company case. Looking at this from the point of view of revenue for the moment, and dealing with the computation of income for tax purposes do you consider that it is reasonable that in a long period of price inflation the effect of price increases should be excluded from income.

MR. LEACH: The taxpayer has reported sales, not reported income on the increasing prices, and consequently if he doesn't get the opportunity of charging his increased cost against that he is paying a very heavy price.

MR. LITTLE: If I might interject, Mr. Chairman, surely this question is no different than the question of your capital equipment in your building and machinery because the cost of replacement has gone up. The Department has not recognized a larger write-off. He is bearing that cost. It seems to me in the circumstances we outlined where we think LIFO is proper, and they are restricted, and purposely so, we don't wish to expand this area, but in the areas in which we think it is appropriate it seems to me that you can look your original inventory of stock on hand in very much the same fashion as your capital investment in building equipment. You don't, in fact, sell this first inventory, the inventory you sell once you get in business, the goods you sell is current cost ~~not~~ matched against today's prices. This happens in certain industries.

It happens in the copper business with conversion. The price one gets for copper tube, there is no relation at all to the stock on hand. It is the current cost plus a conversion factor and it varies from year to year. The same is true with hides, the raw material in relation to selling price, the selling price of finished leather is the price of hide on the American market today. We are really trying to achieve the proper measurement of income year by year, not a cash measurement of dollars laid out and dollars come in.

MR. LEACH: Another good example which is in the newspapers a good deal lately is the sugar business where prices are going up very rapidly based on the current price of raw sugar on the world market.

THE CHAIRMAN: As opposed to it being held down in accordance with the variation of inventories.

MR. LEACH: That is correct.

MR. STEWART: Could I refer in this connection, and I am referring now to a 1955 document, and I appreciate that accounting thinking moves on, but in 1955 there was a report issued by the United Kingdom Royal Commission on the taxation of profits and income. They dealt among other things with the valuation of inventories for tax purposes and they said this at page 145:

"We don't accept the idea that it would be impossible to frame a set of rules that would adequately control the traders freedom in the adoption

> of an accounting method or in the change from one accounting method to another without requiring universal adherrence to LIFO. We think that an adequate control is secured for this purpose if effect is given to the principle that despite rising prices there is no premium exclusion from taxable income to an element to reflect the fall in the purchasing power of money".

Then they go on to say, they set out in the course of their report a scheme which they have worked out and which they recommend for adoption in the United Kingdom.

MR. STEWART: That scheme is set out on page 477 of their report and it deals with changes in the traders method of evaluating stock in trade. They say that the basic treatment is that the trader will count as profit or loss respectively the difference between his costs and the ultimate sale proceeds of his stock in trade.

That is to say, in spite of rising prices no permanent exclusion trade in fact is permitted to reflect the value on the purchasing power of money. Nevertheless during the continuance of his business, a tradershould be permitted to evaluate his stock in hand on the basis appropriate to the type of business carried on, it may provide that such business, if it occurs consistently over a period of years, clearly reflects his profit.

Then they proceed to set out a number of basis on which they are prepared to recommend for the valuation of inventory and LIFO is not one of those methods.

There again there seems to have been a real concern about the exclusion of their income for tax purposes to the spread of increases in the value of inventory.

MR. LITTLE: Well, there certainly are, Mr. Stewart, a number of differences between the British approach to accounting, even today, and ourselves and there are other approaches to inventory that we in this country find difficult to accept. For example, the exclusion from inventory of overhead so, I do not

think that we should assume that anything British, say, in this connection is necessarily appropriate for us; but I think that all I can say is in this particular approach which runs through the quotation which you read, -- perfectly naturally, one is thinking of the merchandiser who buys this glass and sells it or buys this shirt and sells it. He does move that shirt. It is this particular shirt he sells. He makes what price he can.

However, the fabricator of copper, for example, is not actually in the business of selling copper. He is in the business of selling conversion cost. His end price goes up and down. At all times his measure of profit includes his conversion cost. It includes, as it were, capital cost and the material he must put in. It doesn't matter to him at all what the current price of that material is. It goes up or it does down. His price goes up and down. This is incidental really. If you take it another way, then it seems to me that you have a concept of income, but the present merchandiser, what does he sell? What he has to sell is conversion cost in this respect. He is not interested in selling copper per se.

This is quite different from a retail merchant who buys a tie and sells it over the counter.

MR. LEACH: This is a new field but it is interesting to note that three years ago our English institute brought out revised bulletins on inventory values and accounting. It was brought somewhat closer to the position in which we are. I might mention I

support Mr. Little's statement.

MR. STEWART: Can you say whether when LIFO was introduced in the United States or was accepted in the United States for tax purposes, it was accepted for a relatively limited number of industries.

MR. LITTLE: Perhaps Mr. Simonton could answer this. I believe it was and that has since been extended.

MR. SIMONTON: I looked rather briefly into the background of LIFO in the United States. Initially it was introduced in a restricted area. One of the earliest industries was the oil industry in the United States. Over the years the use of LIFO has broadened considerably in the United States; probably affected to some extent by the attitude of the tax authorities in that country.

I cannot give you any precise figures about the percentage of the, say, larger companies in the United States that use LIFO today but it is a fairly significant percentage. I am quite sure of that.

MR. STEWART: Is it not a case, Mr. Simonton, that it has spread from a restricted group, to which it was initially applied, to the point where there are relatively few industries in the United States now where it may not be used for tax purposes.

MR. SIMONTON: I believe you are correct. It has spread from a restricted group and there would be very few, if any, industries in which there are not examples of companies that are using the LIFO base.

MR. STEWART: Do you think if it were introduced

into Canada, in this very restricted area of which you speak, it could be kept within bounds here?

MR. SIMONTON: Well, this is an area I have had some concern about. I agree with what Mr. Little has said and its restrictive nature in the application of LIFO, but I personally would have some concern that it could be held to that restrictive area, and it will present some difficulties in administering such a provision in the Act.

MR. LITTLE: Mr. Chairman, I would like to supplement that reply. I agree entirely with Mr. Simonton. This matter was of concern to us in our discussions. There is no question but that if introduced in a restrictive way, there will be pressures from those who are on the fringe who think they might comply and the moment you widen the fringe, there are more people entitled to protest.

Our conclusion though really was this -- this is true of other recommendations - that we thought it was wrong of us to try to restrict ourselves to recommendations that could be controlled or that are politically acceptable. That is not our function. We have recommendations in here which I am sure will be politically difficult and we also have recommendations such as this that would be difficult to administer. Nonetheless this does not detract from the major principle we are trying to bring forward, which is fairness and reasonableness and equity in the measurement of income.

THE CHAIRMAN: From our point of view I

think it is perfectly clear. I would like to ask you if you have any suggestions as to how such treatment as this would be administered and would be kept within reasonable bounds? I know that is what most people have been primarily concerned with; first, how to write the regulation or law which brings in those cases that most accountants would be prepared to say "This is a proper case"?

MR. LITTLE: We must be the first to admit this is a difficult area and what we envisage can only be accomplished by a strict delineation of who can apply and it would be restrictive. There is no question it would result in pressures.

THE CHAIRMAN: Would you think that there are more than a dozen people who would employ this for a measurement of their income apart altogether from taxation? Let me suggest that there were no taxes in the land. Would there be more than a dozen people who would choose this as a rate for the measurement of their income?

MR. LITTLE: I think there would, personally because long before there was any thought at all that it might be acceptable for tax purposes in this country, numbers of taxpayers have adopted it in their annual accounting because in their view, and this is our whole point, it does present a more proper reflection of the annual purpose of the corporation. I think Mr. Campbell Leach would like to supplement that.

MR. LEACH: I don't think I can improve on it but there is no doubt because this is the best

school of thought used in England for many many years and widely accepted. It had some acceptance here. There is some reference to it.

MR. LITTLE: I think the restriction that we have included in the report, one of which Mr. Leach raised with me subsequently, is that it might be perhaps that there should be a requirement that once it is reflected in its accounts, they choose to adopt it for tax purposes.

MR. STEWART: Reverting for a moment to the American practice with regard to LIFO, can you say whether under the U.S. practice a taxpayer who adopts LIFO must value inventory from then on on the cost basis? He cannot use the market alternative.

MR. SIMTONON: I will speak to that point again, Mr. Stewart. It is my understanding that in the United States, having adopted a LIFO base,the taxpayer is required to stay on that cost basis and from then on and is precluded from write down to market, say but the accounting profession in the United States does not agree with that approach. This, I understand, is on a taxation basis for the United States.

MR. STEWART: If this particular method of valuation were adopted in Canada for the restrictive group that you have mentioned, you would then consider that the alternative lower cost of market should still be available.

MR. SIMONTON: Yes. That is based on what we put forward in this recommendation.

MR. LITTLE: This, of course, is not so much

there should be a determination of income but there should be a reflection of the balance sheet assets at the end of the year and to give you the age old concept of the company, you do not anticipate profits, but you recognize losses.

So, if the market value of your stock has in fact gone below the cost for the balance presentation, the accounting profession I am sure would continue to adhere to this, that you use the lower figure.

THE CHAIRMAN: I think it is worth pointing out to you, Mr. Stewart, that Mr. Little originally said this is a method of cost. He did not say it is a method of valuation. It is a method of determining cost that does not change the normal rules, lower cost of market.

MR. STEWART: Well now, moving on to what you say about reserves on page 12. You suggest the repeal of Section 85(b), among other things. I would like to ask you this: my recollection is that section 85(b) was introduced about ten years ago as a remedial measure when litigation had occurred, the result of which was that deductions in respect of sales of tickets of various types had been disallowed by the Department and were held properly to have been disallowed. If we are to repeal Section 85(b) would we not promptly revert to the doctrine of these cases and these decisions and be in difficulty.

MR. LITTLE: Well, this once again is Mr. Leach's preserve. But I would just like to say I think in a case of that sort where they decide today with

no precedent behind to follow, I would like to think they would be decided on a completely different basis.

THE CHAIRMAN: Be determined on what?

MR. LITTLE: On a completely different basis because of the recognition of sound business practices in the determination of income.

MR. LEACH: I have always felt with these cases, if there was more than one, I have always thought they were unfortunate probably in that the parties were too far apart; probably the taxpayer was expecting too much. We know in the tramway has been using tickets and the situation has been building up and up over a period of years.

MR. STEWART: Well, is this another of those cases where we get into questions of timing as regards income for accounting purposes. The proceeds of these sales clearly are income but it is simply a case of when the income should be brought in for tax purposes.

MR. SIMONTON: It is income but not profit.

MR. STEWART: Yes.

MR. LEACH: The timing has been going on altogether too long. The taxpayer was not dealing with the situation. He was not allowed to go on indefinitely.

MR. STEWART: I put it to you, it has simply occurred to me there might be a problem if we repeal Section 85(b) and do nothing to override the effect of these decisions. Very simply, you would have no objection to whatever was necessary being done.

MR. LEACH: I would not.

MR. STEWART: Now, on page 13 you deal with the question of business expenses and the deductibility of such expenses and you seem to take the approach that all expenditures, except those relating to land, security and goodwill, should be allowed for tax purposes, either as current expenses or as a depreciable expense. Is that the effect of your submission?

MR. LITTLE: Yes. That really is it in essence, so far as you say we do exclude land, securities and goodwill.

What we are really saying there in effect is that the expenditure that wastes away in the income earning process ought to be allowed as a deduction from the income that is so produced.

While we have not included that in this chapter or in the appendicies dealing with the novelties, we point out a number of such examples and they really become quite absurd when you think of them.

You take a taxpayer who must pay something to a municipality, for example, to permit an overpass or turnoff to gain access to his plant. That surely is a direct outlet to earn his income and yet if it does not fall within a prescribed clause, there is no deduction.

The same is true in respect of these things. It is just as in the gondola case in the west where he acquired no title to the gondola but there was no question in anybody's mind that the gondola was operating and produced his income.

If on the other hand it is something he retained ad infinitum and does not waste away, this can be true of his land or his goodwill or his investment and so on, of course, no write-off.

But, on those things that are used up and absorbed in the income producing process, seems logical to us to be a profit offset against income.

It is simply a fact that a fairly restrictive definition of assets has excluded certain things.

MR. STEWART: Mr. Little, let me ask you this: Is it reasonable to expect all business expenses should be allowed either currently or over a period, without expecting that all business revenues should be brought into account.

MR. LITTLE: Certainly not, if they are of an income nature.

MR. STEWART: But I am ---

MR. LITTLE: You say "revenues". Perhaps you meant "receipts".

MR. STEWART: Perhaps "receipts" would be better. I recall what you said a few moments ago on the question of capital gains that we are concerned with taxation of income and not of capital; but are we not or are you not suggesting that items which will ordinarily be regarded as of a capital nature should be deductible either at once or over a period, th[illegible]

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MR. STEWART: Yet you are not prepared to accept the converse, that anything which comes in as the result of operations should be brought into income?

MR. LITTLE: No, I entirely disagree. I didn't intend ---

MR. STEWART: I am afraid I haven't made myself plain. You are suggesting that everything be deductible.

MR. LITTLE: Everything that is a necessary cost in the income earning procedure.

MR. STEWART: This tax, in fact, on your approach includes virtually everything in the way of expenditures. You do provide for some relatively minor exceptions. Yet it does seem to me that some of the expenditures that you would propose should be written off over a period for tax purposes, would ordinarily be regarded as capital expenditures for that particular business. Admittedly they may have a restricted business life during the course of the operation. If in the course of the operation one of those particular assets is sold and a capital profit or gain results does it not follow that these proceeds should be brought in?

MR. LITTLE: Possibly.

MR. LEACH: It is dealt with substantially in the capital cost allowance regulation, a close parallel. The capital cost allowance is brought back in the revenue and anything over the original cost is capital gain. There is a precedent for that form of treatment.

MR. LITTLE: You take for a particular

example, a building and a piece of equipment, it serves one purpose only and that is to produce revenue. It is The only difference between, from an accounting of view, between that and the raw material that goes into the plant is that the raw material is consumed in a matter of months and buildings and machines last a number of years. Notwithstanding these two elements combined because the cost must be recouped from the end product. You are taking us one step further and suggesting if it is fair, if the building and machines cost $100,000.00 and is properly amortized against the income, if I am then able to sell that building and the machine for $200,000.00 that I should not pay tax. I think the answer to it is that in a vast majority of cases that the person who does dispose of the building and the machine does so because he must replace it with something new. If he does and he sells his $100,000.00 business or machine for $150,000.00 he promptly lays it out on a new asset. If you remove one-half of this increment from him by way of taxing it does that replace it? I think that is in essence the difference in approach.

MR. STEWART: I grant the force of what you have just said, but it seems to me there are two things, one is whether or not the proceeds should be brought into income for tax purposes and the next question, if some of these things which are not presently brought in are required to be brought in, then do you insure that the taxpayer is not going to be crucified in the process; in other words you may have

to have some method of averaging income or averaging the tax which results from the receipt of what we have called capital gains.

MR. LITTLE: I don't think we are suggesting that anything else be brought in.

MR. STEWART: No, you are not.

MR. LITTLE: We are suggesting the restricted nature of the definition of class for capital gains allowance purposes be widened to the point of actuality to allow all of those things which are in the nature of a capital assets to be amortized.

MR. STEWART: You are saying something which is obviously perfectly reasonable. You are suggesting what the ordinary taxpayer would suggest, that he get maximum deductions from income in respect of his business expenditures. I am the one who is raising the opposite side, the opposite point of view. I am asking you to comment on the proposition that if all these expenditures are going to be deductible over a period should it follow as far as the businesses are concerned that all receipts should be brought in in one way or the other.

MR. LITTLE: Not necessarily because I am not suggesting that all disbursements should be deductible.

MR. STEWART: With limited acceptions. You simply used the word "possible". That is good enough for me. We are not here to decide this. We are here to canvass the subject.

MR. LITTLE: When I say possible, certainly it is open for argument. I suppose there are arguments

on both sides. It wasn't one we accepted.

THE CHAIRMAN: The argument in favour of the deduction of almost everything, I would assume, Mr. Stewart, if one has a business and is taxable it is because it is designed to earn profits, and therefore all the money it is spending is towards that purpose. Conversely as Mr. Stewart points out if one accepts what you have put to us and one sells a building or piece of equipment at more than its original cost, that there is something less than recapture, over and above recapture and that something else should be brought into income by the same argument, for the same reason that I have just put forward as a justification for the deduction of all expenses. Is that not really what we are reaching for?

MR. STEWART: That is exactly it.

MR. LITTLE: I think that is perfectly true. I think the point we were really attempting to make, Mr. Chairman, in this section was simply to clarify and improve upon the existing method. What we are saying in essence is that class X allows you to write off a building with a tin roof but not one with a slate roof because someone forgot it in the legislation. This is hypothetical. I hope the press isn't reporting it across the country.

What I am saying is that by a technicality certain classes of assets have been omitted from those that are described and which therefore could be amortized and we are simply saying there are additional items which are of exactly the same nature for which

there should be a write-off. We are not trying to change the concept of determined taxable income.

What Mr. Stewart is trying to get me to say is we would like flow out of cash to be deductible and we will segregate certain of the income items as taxable.

MR. STEWART: Mr. Little, I conceded I am perhaps taking advantage of an opening you have made here. You have under the heading of business expenses, you have suggested certain items which haven't been heretofore allowed to be deducted, and I am taking that proposition and I am attempting to discuss with you from the point of view of this Commission whether if virtually all expenditures are to be allowed and I think there is an excellent case for it myself, for what it is worth, I think there is a very strong argument that, if reasonable, business expenditures should be allowed at one time or other in the income of the earning process. I am simply suggesting to you if this is to be the rule the Commission may have to consider whether all revenues shouldn't be brought into the income, assuming that they arise over the life of the particular business tax.

MR. LITTLE: I don't think we could properly accept such a broad statement as that. What you are really saying is that every item of income is taxable, every item of out go is taxable. Then you wouldn't have the problem of capital gains any more. You tax net cash flow.

THE CHAIRMAN: Subject to your clarification

as to certain items.

MR. LITTLE: That is correct, but I think we -- Mr. Stewart is quite right, he has taken up an opening we perhaps inadvertently allowed him. We weren't intending it at all. If you look at the items delineated in Appendix E you will see reference to things such as a person working on a number of different hydro sites, for examples and one emerges. There was considerable expense, or someone who goes abroad to develop business who fails to develop the business. We are simply trying to remove what to us is unreasonable restrictiveness in the present application of the approach to the determination of income. We are not changing the concept.

MR. STEWART: You or I could give half a dozen other examples to add to your Appendix E. There are a great many, but you do get to the point, I think, when you are considering deductions, what should be done logically as regards revenues or receipts.

MR. LEACH: Doesn't it come back to the fundamental question what is capital, what is revenue.

MR. STEWART: It might.

MR. LEACH: What is tax revenue, and leave capital there. Then you come into these first examples we have. We say these are either short term expenditures, and not capital or else they are expenditures which create a new type of capital assets which is not provided for. It is when you start to recover some of these things you get into trouble. That

is where we are at now. I think one must attach and direct their attention to deciding whether the things that come back are capital or revenue.

MR. LITTLE: Quite.

MR. LEACH: Answer that and we will be home free.

MR. LITTLE: This problem doesn't arise because of anything we said in this particular section. All we are trying to do is make sense of the present practice. What Mr. Stewart is suggesting to us would apply equally in the present context in the sale of any building or machines.

MR. STEWART: That is right. You are reducing the number of things which will not be affected in one way or another too an extremely ----

MR. LITTLE: Logical.

MR. STEWART: It may be logical, but an extremely small limit. As I look at it on page 14 everything is now to be allowed except expenditures on land, security, and good will provided the expenditures are made for the purpose of gaining or producing income. I don't quarrel with that proposition. I do ask where it leads us.

MR. LITTLE: I can only say this, the method we now pursue applies to a far greater extent to everything we now have as allowable deductions. This is a very limited exemption really of the things that are now deductible through capital cost allowance if the question is whether or not everything that is allowed to be amortized under the Act, under the capital gains

schedules to be fully recoverable and then if you reap more than your original capital cost, then I think our answer must be no.

We have taken a stand on taxation of capital gains, and this in our mind would be a pure taxable gain.

MR. STEWART: Now, Mr. Chairman ---

COMMISSIONER PERRY: I wonder if I might interject. I think the problem which is perhaps involved in the discussion we have been having today, it is a question not as to whether it is capital or current but whether it is capital expenditure which should be amortized or one which should not be amortized. In other words you get into an area of nothings. It is quite obvious that the three main exceptions you have listed could be regarded almost as investments. There is no doubt this security is not used in the course of earnings of income, nor is land, but there are still some nothings which do give permanent value to the business which are just as in evidence five, ten, twenty-five years from now as they are at the time. What I am coming to is have you touched on differentiating these two kinds of capital expenditures or whether in your view it doesn't matter. If you are willing to exclude the three types you have mentioned from everything else into a capital cost allowance clause subject to recapture then, in fact, I think you are putting forward an answer which might be conceivable, but it really does evade the main question as to the setting of rules for determining

which capital expenditures should be allowed and which should not.

MR. LITTLE: Perhaps, Mr. Perry, before we reply you could tell us the sort of thing you have in mind that is in evidence ten, twenty-five years from now.

COMMISSIONER PERRY: I have grave misgivings for example, as to whether the cost of examining these various power sites should be allowed. Surely the knowledge that a power site is not an end-use is just as good twenty-five years from now as it is today. It prevents you from ever committing the folly of building a project on that particular site. There is the knowledge which doesn't deterioriate.

MR. LEACH: The problem was to find a right site, not a wrong site.

COMMISSIONER PERRY: In the process they discarded several sites that are wrong and the knowledge they were wrong is just as good 100 years from now.

MR. LEACH: I submit that they are looking for the right site and when they find it they use it and the cost involved in finding that site should apply.

COMMISSIONER PERRY: Is that knowledge going to deterioriate?

MR. SIMONTON: This knowledge would protect you from losing money, not making money. I don't think that sort of expenditure should have any enduring value or could be allowed as current value for tax purposes.

COMMISSIONER PERRY: I am inviting you to tell me why and by what sort of general rule do you decide this? In other words what is an enduring value?

THE CHAIRMAN: Would you like to consider that during lunch time. You are through with Chapter 2, are you? Going back to the matter of generally accepted account principles I have one or two questions and I daresay some of the others have. Mr. Stewart started off by drawing attention to the fact that Professor Coutts considered it was more than an accounting method of determining profits, he indicated it was an economic method of determining profits. He also referred to a tax method. I would think that we were concerned as to what the tax method will eventually be, will it eventually be an accounting method or will it eventually be an economic method?

I would like you to tell me, if you will, whether you would not believe that some reference to accounting in the Statutes would tend to keep our tax losses more closely related to accounting terminology? In fact, it does cause some concern that the courts might be guided by people who are not accountants in coming to a conclusion on accounting.

I have always felt accountants were singularly well equipped to do that and if it was not so, they lose the major part of their raison d'etre. This is a task which has to do with their skills. I would hate to think somebody else is going to come along and take over this role because they approach it with different forms of measurement. Would you like to speak to that?

MR. LITTLE: I suppose, Mr. Chairman, perhaps we are shortsighted and arrogant in this field but our view was that there is no other basis and I have accepted that fact whether or not these words are introduced into the Act; because of the inflexibility it might introduce in other ways and the restrictions it might have on the future development of our practice.

THE CHAIRMAN: It might be there is some other way to determine income than accounting.

MR. LITTLE: By the standard of or definition of income we now accept, yes.

THE CHAIRMAN: "We" being whom?

MR. LITTLE: Accountants.

THE CHAIRMAN: I am thinking of communities.

I am sorry, but certainly we accountants think of it as

being based on accounting and I think the community does generally. I am frightened that if we allow our tax law to follow any way they might, that there may be some departure from accounting which could be serious. We have seen similar departures from accounting. You do not share that concern, I take it?

MR. LITTLE: No, certainly not personally and I don't think as a committee we do. I think really the public as a whole would be even more surprised than the accounting profession to find a departure towards the economic approach to income.

THE CHAIRMAN: Well, the economic approach perhaps ---

MR. LITTLE: Recognizing unrealized gains or revaluing to current dollar basis and so on. I think the public is going to require more education than the profession in this matter if we come to this.

THE CHAIRMAN: We have already seen one large national Canadian company go to that, although it is not generally in accordance with generally accepted accounting practices. I think I am right, am I not?

MR. LITTLE: I think you are right. I think they certainly say it is.

THE CHAIRMAN: I am sorry, I am not criticizing.

COMMISSIONER GRANT: Just in furtherance of your remarks, Mr. Chairman, I have a feeling that Mr. Little would subscribe to the use of the words "accounting principles and practices" in the statute if he felt that there was a danger of a court applying

other than accounting principles in determining what was the practice.

MR. LITTLE: I think that is fair.

COMMISSIONER GRANT: In other words, you think you can get your 80 per cent vote on that?

MR. McMACKIN: Don't you think we can depend on the good sense of the courts; certainly on their realization that in a practical sense and a business world, there just is not any other way in which they can be determined.

COMMISSIONER GRANT: That is your premise.

MR. McMACKIN: I think we can trust the courts to do that.

MR. TOWNSEND: I think, Mr. Chairman, we are probably placing some reliance on the wording of Section 4 which provides income from business be profit and I think while there may be an economic concept of income, does this concept also apply to profit? I assume Mr. Perry is aware ---

COMMISSIONER PERRY: I don't know whether it does. It could be psychic, psychosematic or anything else.

MR. TOWNSEND: We are placing reliance and we do feel accountants determine profits. Other people may determine income but certainly we spend most of our time determining profits.

MR. LITTLE: I would add "illusory" to that.

THE CHAIRMAN: I think this might be a good breaking point.

COMMISSIONER BEAUVAIS: I want to ask you a

question, Mr. Little so you will have a little time to think about it during lunch time. Suppose that you spend a few thousand dollars just investigating a power site and you do not build any power sites at all. Do you think it should be amortized, the cost of that work that has to be done?

MR. LITTLE: I would think this would depend on the purpose one had in seeking a power site. If it is someone who is trying to make a business, want to build a power site and take on the Quebec Hydro or take on a municipality and he does some investigation to find out what is the cheapest and best way to acquire his power, then I think that is a business deduction.

If he is simply a promoter or prospector and he decides possibly I can build a power site and sell power to somebody or perhaps I can go into the gold mining business, and he spends some money in seeking out a power site or doing a little diamond drilling or he could invest in the market. There are a number of things he could do, which he does not do at all. I think in that particular case he is risking his capital.

THE CHAIRMAN: I think we will stand over until 2:15 o'clock p.m.

---Whereupon the adjourned at 12:45 o'clock p.m.

---On resuming at 2:15 p.m.

THE CHAIRMAN: I think we will go ahead without Mrs. Milne. Mr. Stewart.

MR. STEWART: Gentlemen, I would like to move to Chapter 3 of your submission which is entitled ---

THE CHAIRMAN: Before you do that I had better ask the Commissioners if they have any further questions on chapter 2. No. Go ahead.

MR. STEWART: Chapter 3 is entitled Corporate Taxation and Associate Companies. I would like to start with some general questions about corporate taxation before moving on to associate companies. I take it that we would agree that the basic system of taxing corporate income in Canada involves treating a corporation as a separate entity, taxing that entity on its income as the income is earned, taxing the shareholders then on distribution to shareholders of the balance of the corporate income, this b eing subject to the fact that resident shareholders pay 20 per cent dividend tax credit. Is that a broad summary of our system?

MR. LITTLE: The existing system?

MR. STEWART: Yes.

MR. LITTLE: Right.

MR. STEWART: Could I ask whether in your deliberations you have considered alternatives to that system?

MR. LITTLE: Yes. There is only one alternative, presumably to taxing corporate profit and that is not to tax corporate profit and that really is

the alternative. There naturally would be a variety of rates that could be applied to corporate profit under the taxation system, and, of course, we have expressed views in that respect, but our basic alternative choice is either not to tax the profit at all or tax it under the nature of withholding tax. I note a great deal of interest has been shown in the suggestion that the corporate entity itself ought not to be taxed but that it is individual shareholders who should bear the tax because the end result we accept is the fact. People pay tax in the end results. However, in our deliberations we have dismissed it on two accounts, really. We thought that the distribution to the revenue producing process for the government would be extremely difficult. We can't see without major changes in the whole taxation philosophy which we really haven't considered how you could recoup the quantum of revenue that is now raised by the corporate tax. In addition to that we think that the corporate operation as such which is the vehicle that accumulates profit and spends and reinvests ought to pay taxes as it goes, and that it is much more simple to tax that profit than to try and levy these taxes against the shareholders, wherever they may be and also we think that in our economy that our principle traders and competitors in the western world rely on this form of taxation and that to make a change of this sort might have an effect on our costs and our trade position which, frankly, we can't foresee. As we have indicated in the first chapter of our brief we are not economists nor did we employ any economists to

assist us in assessing what a change of this sort might do but our conclusion basically is that our system can work reasonably well with the adjustments and the alterations that we propose. We think if you took a step such as this then you create a whole tax system and start fresh and this simply is a matter we haven't explored to the end because we really are not competent to do it.

MR. STEWART: The alternative that you have just been discussing, Mr. Little, is one in which corporate taxes are abolished and the corporate income is taxed in the hands of the shareholders, is that correct?

MR. LITTLE: Yes.

MR. STEWART: One other system of taxation, a system of corporate taxation which has been suggested and which has a somewhat similar result as the one you have just described is that of treating the corporation for tax purposes as a partnership. You in your submission conclude that this is a method which might be suitable for a restricted type of corporation with a particular type of capital structure. Do I take it that you wouldn't consider that this basic method is suitable for other types of corporations?

MR. LITTLE: Well, the reason we put forward that proposal is to achieve fairness and equity as between taxpayers because a closely held corporation with small profit, if one were to adopt a flat rate of tax which we propose conceivably would pay a higher rate of tax on income than if necessarily the same

business were conducted by a group of partners. Our conculsion is that one should not be able to benefit by incorporation; in other words one should not be able to achieve a lower tax burden through incorporation as is now the case, and one the other hand we don't think one should be penalized if by choice or necessity he operates through the corporate vehicle. This option really is to make it possible for a group of individuals operating a corporation to have exactly the same tax status as though the same individuals operated a partnership.

MR. STEWART: If we approach this question of corporate taxation from the point of view of equity is it not a fact that our present system contains distinct inequities in that a person with low income is paying a high tax in respect of what you might consider to be his share of the corporate income and the person who has a high income is paying a lower tax than perhaps he should because of the fact that our corporations can accumulate income and he doesn't therefore have to pay tax on distribution.

MR. LITTLE: Well, this is quite true and this opens up a very definite problem because when one suggests that the low income shareholder is bearing a high rate of corporate tax one must ask oneself does he bear any tax at all or is the corporate tax borne on the other hand by the customers of the corporation or by the wage earners and is it, perhaps, fair to suggest that the investing public demand a certain rate on investment and will look to the various areas of

investment -- and look at the after tax return that comes in. In their eyes they are not paying any tax at all. I am not trying to steer around the question, but I want to make it clear that there are other things that must be considered when one thinks in terms of the small income shareholder bearing a high rate of corporate tax. This is, perhaps, not fair in its entirety. Of course what you say is exactly true, that the person with the large income doesn't draw income from the corporation, obviously doesn't pay the tax, and this follows obviously because neither has he drawn income. This, it seems to us, of course, is one of the arguments in favour of the continuation of the corporate tax, for this very reason that as the income earning process continues that this process bears a share in the cost of operating this country, so the tax is taken. It is true, of course, in our system if one draws no income one pays no tax.

MR. STEWART: I am not quite sure I understand where you stand on the question whether this type of tax system which you advocate for the small corporation with one class of stock would be suitable for larger corporations as well?

MR. LITTLE: No, we suggest it really basically for simplicity. We don't think it is necessary. The 1000 shareholders in a corporation that makesgood profit are in quite a different position than the three or four family members operating a business together.

MR. STEWART: When we come to contrast the

Canadian system with the United Kingdom system there are, of course, a number of differences, but I wonder if you have considered the application to Canada of something like the U. K. system too restricted, so that there is simply one corporate tax. As I understand the working of that system, if we confine it to the one tax, the corporation pays this tax and then when it comes to distribute dividends the shareholder takes into account the grossed-up value of his dividends and gets credit for his portion of the corporate tax. Have you considered the relative merits of that system in our present system so far as Canada is concerned?

MR. LITTLE: Yes, we have, and I think perhaps it I might ask Mr. Simonton to speak on this matter -- this is an area that he had paid particular attention to.

MR. SIMONTON: Well, there were a number on our committee who did study this area. As you say under the U. K. system, their basic rate of tax applies both to corporations and individuals and the individual gets credit for that tax. I think it would be somewhat similar in Canada if we had a divident credit equal to our corporate rates. This isn't possible at the present time so long as you have a dual rate, a lower rate on $35,000. This restricts our divident credits to about the 20 per cent level, the corporate rate applying to the first $35,000.

MR. SIMONTON: I personally do not feel that the U.K. system would simplify or improve the taxing procedures in Canada.

I do not look upon it as a radically different system than ours either because they do apply surtax to the individual in respect of income over the extended rates. Conversely, unless there are allowable deductions, you have refunds that bring them practically below the standard rate.

MR. STEWART: In each case, as I see it, there is no complete integration of corporate and personal taxation? Integration is limited to the portion of the corporate after taxes profit, which is distributed.

MR. SIMONTON: That is correct, yes.

MR. STEWART: Do you think that the English system would eliminate -- be more likely to eliminate than the Canadian any bias which exists now under the Canadian system against equity financing.

MR. SIMONTON: No, I don't think that would be the result of using the English system.

MR. STEWART: What I am thinking of is that if we adopt the English system here and had simply one corporate tax and one rate of corporate tax the individual getting full credit for corporate taxes on income, which was distributed to him, so that he will be able to recover in the event that the corporate rate was a standard rate or higher than his personal rate may have been. Do we not get very much where we would be if the dividends were taxable in the computation of corporate income.

MR. SIMONTON: No, I don't think we do because in the operation of the U.K. system the standard rate of tax applies to the corporate income, more or less as it is earned; although they have a bit of a time lag in their assessing procedures but a corporation may still retain after taxes earnings indefinitely.

In so far as they retain earnings, their system is very similar to ours. It is only at the actual distribution that this secondary effect comes into force whereby a shareholder gets this credit, similar to the standard rate applied to the corporation; so I think you have to keep in mind the point of whether there is an actual distribution.

MR. STEWART: Yes, but now I would like to make one more effort to indicate what I have in mind here. I am not at all sure what the right answer is. I am not sure you and I are not at cross purposes at the moment.

As matters now stand in Canada if a corporation undertakes debt financing and pays interest to the holders of its obligations, it is entitled to deduct that interest in the computation of income, as well as the interest. The recipient of the income deducts it in its particular rate.

Under the English system, if it were extended to Canada with the qualifications I have mentioned to you; simply have one corporate tax and one rate of corporate tax, we do not at the moment permit dividends to be deductible from the computation of income; but to the extent that dividends are paid and

the recipient receives them and deducts the credit for the corporate taxes paid on that portion of the corporate income, do we achieve substantially the same result as we now do as regards interest.

MR. SIMONTON: Mr. Stewart, I am a little confused in this area. I think on the U.K. system to the extent that earnings are paid out as dividends, then the effect as between interest and dividends will be similar.

MR. LEACH: Mr. Chairman, may I make a brief comment on that?

THE CHAIRMAN: Yes.

MR. LEACH: I think we are talking of public companies when you speak of debt financing versus equity financing. It occurs to me these things find their own level of debt and by and large which gets 6 per cent interest and the yield on common stocks is around 3 per cent.

It seems to me the answer is how you want to do it. On top of that the recipient of the dividend gets a dividend tax credit.

As I say, I think the market place establishes the level for these things and if you put in another system, you will get a different price structure but probably it would all settle down.

THE CHAIRMAN: This was the answer that I was hoping would come out. You put the question, Mr. Stewart, on the assumption that there was a bias in favour of debt financing.

I want to know if these gentlemen think

there was bias in favour of debt financing. I think Mr. Leach has indicated he does not believe so because to the extent that there is bias, it is taken up by the prices at which securities are issued.

MR. LEACH: Like so many other things, there are all sorts of views on it. Inmany circumstances people, from a company point of view, will be biased to financing by means of debt. What I said earlier still holds true. I think it levels out.

MR. LITTLE: Surely, Mr. Chairman, that is the answer. If there is a bias -- I don't admit there is a bias -- but if there was a bias towards debt financing it is because people who are operating businesses would prefer to borrow rather than trade on the equity standard.

The more they can borrow, the greater reward for the common shareholder. They will have to pay certain price to induce the capital market to provide funds. It seems to me to be a question of supply and demand.

I would not have thought that our tax system really has had a tremendous influence on the form. I do think and we make this point, that the tax structure can reach a stage where it does impede or restrict forms of capital and the willingness of people to take risks.

THE CHAIRMAN: Your answer is directly opposite to what we received very recently from a group of rather senior financial people of corporations who said that they believed that because of the Canadian

tax system the burden of taxes on corporations, that there was a very strong prejudice in favour of debt financing.

Of course, they were speaking from the point of view of corporations.

MR. LITTLE: I would not have thought that that made very much difference because the dividend credit, while it is of benefit to the shareholders, is equated with the effect on the corporation therefore it is of great interest to us that our tax system does not really restrict financing in favour of debt financing.

I think, if I may, I will add one further comment, Mr. Stewart. In assessing our approach to corporate taxes and our decision to discard the U.K. system, I think you must also bear in mind that one of the objectives by which we approach it has been to solve the very difficult and serious problem of the high tax rate on the eventual distribution and that the high progressive personal rate has led to the dividend stripping problem. For example, there are a great variety of ways that are now provided to corporations to move surplus. This, we are confident, stems from the impact of the high progressive personal rate applied to corporate income withdrawn.

As we see it, the English system basically also embodies a progressive feature on the personal side that has led to exactly the same problems we have here, the dividend stripping, which in the U.K. is of just as much concern to the revenue authorities as it is here.

There are methods of trying to block and also what you can do about losses. There was also the problem of deductibility of dividends for tax purposes, in addition to those we mentioned.

MR. STEWART: Well now, I am not sure I understand one part of what you just said. If we maintain our present system -- let us qualify that by eliminating the dual rate of taxes -- let us assume we have a system of taxing corporate income at a flat rate and that we provide that, just as interest can be deducted now, both interest and dividends can be deducted; if we do not attempt otherwise to penalize the corporation if it retains income and does not distribute it by way of dividends. Would you still be opposed to that change?

MR. LITTLE: Yes, I think so. I think we are getting into the question here of particular attention to the revenue aspect because if a company operates for ten or fifteen years with no distribution and then distributes its entire surplus which results in a tremendous rebate by the government, where this is a factor, it is going to be disturbing to the regular flow of income to the government.

THE CHAIRMAN: You talked about refunds on taxes. I am not quite sure how refunds come about there.

MR. LITTLE: If a dividend is deductible from income and no dividend is paid -- let us say you would have a $100,000.00 for ten years in a row and no dividend is paid, presumably you would pay taxes ---

THE CHAIRMAN: Yes.

MR. LITTLE: I would assume under any system you are describing, at the end of the road, if surplus is entirely paid out by way of dividends, it then becomes deductible.

MR. STEWART: Let us suppose we provide that dividends should be deductible at any particular year to the extent of the earnings of that particular year.

MR. LITTLE: This, I would think, would be discriminatory and unfair because one of the aspects of the availability of dividends is the cash that is available, not profit. Profit may be reinvested in bricks or mortar or any material and it is the cash flow plus profit which you must have available for dividends. I just don't think that would work.

MR. LEACH: It doesn't make sense for a public company where there is a standard pattern of distribution, forty, fifty or sixty per cent of the profit every year, but there are many other companies, privately owned companies, where the pattern of dividend distribution is very irregular, where in fact they cannot pay them out because they are invested in other directions.

Consequently it would be a very disturbing thing to provide that dividends be deductible annually without being paid.

MR. GORDON: Mr. Stewart, one of the points that was very significant also was with respect to foreign investment. We have a 15 per cent withholding tax. If we deduct it here, our foreign investors would

have quite an advantage theoretically on terms of our taxes at our expense.

MR. STEWART: Yes, I have heard it suggested that is one reason why in this country we have a dividend tax credit as opposed to something like the English system. Our dividend tax credit is restricted to resident shareholders.

Well, while on the subject of corporate taxes you indicate that you think that the corporate rates should be reduced. Have you considered at all what relation there should be between the corporate rate and the top rate of taxes on personal income.

MR. LITTLE: Yes, we have. We are not suggesting that they should equate but we do think they should be brought very much closer together.

MR. STEWART: Now, on page 19 of your submission you indicate in paragraph 63, that you think that the equalizing of the tax position of incorporated and unincorporated businesses is the only relief to which the small incorporated business is entitled for reasons of equity.

Then you go on to deal with the question of new businesses. You say at the bottom of the page that a more positive approach to help new business would be the granting of financial assistance towards the cost of fixed assets required or alternatively the provision of suitable industrial plants at attractive rentals.

This question of taxation of small business and new business is one which is also current in the United States. I would like to get your reaction to a

number of points which have been raised there and I am referring in this regard to a pamphlet entitled "The Federal Revenue System, Facts and Problems 1961", which was published by the U.S. Government Printing Office and contains materials assembled by the Staff of the Joint Economic Committee of the Congress of the United States for the use of the committee.

MR. LITTLE: Excuse me, who prepared it?

MR. STEWART: According to the cover these are materials assembled by the Committee Staff of the Joint Economic Committee of the Congress of the United States for the use of the Joint Economic Committee.

At the point I am going to make use of this book, they are dealing with taxation on small and new businesses.

They say at page 36:

> "That one view is that the requirement of small and new business can best be met by general improvements in the economic climate other than by special tax treatment. According to this view, general fiscal and monetary policies contributing to a steady and strong growth in total demand, while avoiding inflationary excesses, would more surely provide the conditions under which new business opportunities

are abundantd than would any differential tax treatment consistent with them; that the basic standards of a good tax system. are Of particular importance, it is maintained, are more liberal monetary and credit policies that have been pursued in recent years."

Now, this is simply one point of view. Would you have any comment on that?

MR. LITTLE: Yes. I think that we would subscribe to that philosophy. Our feeling is that the reason small business requires a different rate is because the ordinary rate is simply too high, and because that rate is too high the problems of the small business have been compounded.

One of their problems certainly is the obtaining of credit, the borrowing of money in various forms, which is obviously far more difficult for the small business without established credit and without access to the markets than it is to the big public companies.

It seems to me that in this respect there have been a great number of important considerations being taken by this country in making funds available to various governmental agencies, both Federal and Provincial, I think that the whole credit approach of the banking system is perhaps a more liberal one than it was twenty-five years ago; but we find it very hard to convince ourselves that the right way to encourage small business is to provide some special tax concessions.

In the first place people will say "Well, small businesses do not make money in the early years" and once they have said that, they have answered the question because if they don't make money they don't pay taxes.

If they do make money then why should they not pay the ordinary proper rate of taxes on that income?

The only reason for allowing them any concessions is to permit the accumulation of capital for expansion. If this can be done in other ways, then in our view it would be better because it is done not by subsidy from one taxpayer to another.

MR. STEWART: Well now, in the discussion which took place in this book that I mentioned there are a number of other methods which are suggested for providing relief for small and new businesses.

These are all on the assumption that a low rate of tax would be eliminated -- at least you will see as I go along some of them are.

One alternative which they have suggested is the small and new business be completely exempt from tax at least on a particular amount, such as $25,000.00, of their net earnings for the first three years.

Do I take it from what you have said about tax treatment that you would be opposed to that type of relief?

MR. LITTLE: Well, this is certainly one of the alternatives we ourselves considered in searching out ways in which to relieve the problem that one

obviously creates when you increase the rate of tax on an existing small business; although if this relief is granted new business, of course, it does not affect those in existence at all.

The granting of taxation exemption for a period of years, of course, does offend against the principles of good taxation which we think are important. All people should be treated equally and equitably and there is no discrimination.

I will just illustrate this, if I may, Mr. Chairman. This touches on our whole philosophy of taxing incentives, Mr. Stewart. We feel the same line of argument applies.

One of the incentives that I personally think was a very useful and attractive one in the current Bill C-95 is the exemption to new business for three years and accelerated depreciation for location in depressed areas.

On the face of it, this seems a sensible approach but I have seen very recently a large foreign controlled manufacturer in this country who buys a substantial portion of the output of a Canadian-owned fabricator. Suddenly he realizes that he can form a new business in a depressed area and have for himself a three year tax exemption and an accelerated write-off and supply himself with this product. He has gone to this Canadian-owned corporation and said "We are now facing a decision. We will buy you out;" which means foreign control in the corporation or "if you don't sell, we will start our plant in Canada".

Then one of two things will happen. (a) the Canadian company does not sell and if so presumably it loses a larger share of its output to a foreign controlled company or if it does sell, the industry as far as Canadian control is concerned, is lost.

I mention this because I think it is a practical example of what happens when you try to use a tax area as an inducement to award a benefit to people in certain areas and certain industries and certain times and so on.

As soon as you do this, the likelihood is someone suffers. This is why we would resist -- let me put it this way -- we would accept it if it was imposed upon us, Mr. Stewart, but we would not be the ones to recommend that we give concessions through the Tax Act to small business or new business.

THE CHAIRMAN: To what?

MR. LITTLE: To small business or new business.

MR. THOMAS: One other important matter Mr. Chairman, is that in cases like that in return for tax concessions the government allows that new business to transfer a business from one area to another.

MR. LITTLE: I think we should say this just to get the record clear: We have asked this -- what is meant by small business? Is this a big business with a small profit? Is that a small business? Is a small business with a big profit a big business? What criteria does not adopt here?

THE CHAIRMAN: Mr. Little, you have used the

word "small" a great many times in this chapter. I have underlined it most of those times. I have sought your definition of "small". I have not yet come to it.

MR. LITTLE: That is quite right. It is a lack in our brief.

We are not thinking of the small corporation that makes $10,000.00 profit. We are really thinking of the small closely held family corporation, the small firm. As well as the small firm, the private business having regard to its assets; its productive capacity and its profit is small in relation to the giant public company.

THE CHAIRMAN: If you start to restrict ownership, you may get a very large business and therefore surely restriction of ownership should be accompanied in law by some basis as to size.

MR. LITTLE: Well, that did not concern us because if the Robert Simpson Company, for example, were owned by two individuals and they were so foolish as to adopt the option of paying taxes personally instead of at the corporate rate, presumably they would be crucified.

MR. SIMONTON: They would be taxed pretty heavily.

THE CHAIRMAN: I think probably that takes care of the proposition.

MR. LITTLE: That was our conclusion.

MR. STEWART: On page 20 of your brief you suggest that we should have some element of progression in the corporate taxation, if the dual rate

is maintained. Have you considered who would be the principle beneficiaries of any move of that sort? Let me explain the question by putting it to you this way; that the corporations whose income was less than $35,000.00 would, I take it, have no benefit at all. Those whose income exceeded $64,000.00, which is the top of your scale, would have the maximum benefit and there would be a number of companies in between who would have varying degrees of benefit; but would not the likelihood be that in terms of dollars, at any rate, that the real beneficiaries of this would be the large corporations?

MR. SIMONTON: Mr. Chairman, may I speak to that? I would like to admit firstly this is not the best worded or drafted section in our brief. On second reading, it is somewhat confusing as to what we exactly mean here but as you say, this particular suggestion would merely grant some additional tax benefits to companies between the $35,000.00 and on up to the $64,000.00 level.

MR. STEWART: I suggest that it would benefit everybody whose income was over $35,000.00.

MR. SIMONTON: Yes, it would as this is worded and there would be a loss in revenue. I think a better approach to this would be to say that we presently have $35,000.00 at 21 per cent. Then we take a giant step up to 50 per cent for all taxable income in excess of $35,000.00 and if we want to retain or were to retain the dual rate system but want to restrict somewhat the benefits, then I think a more rational

approach would be to narrow the gap between those two levels; either bring the rates closer together or bring down the amount to the lower rate or probably both, rather than the particular method that is set out in the brief.

MR. LITTLE: I would like to say this in another way. This is really the basic point here. We do not really recommend the retention of the dual rate system at all.

Our terrible concern is that in spite of everything we may say and this Commission may say that some political group might find it is difficult to swallow.

If then one assumes that you must have a dual rate then you are accepting the progression for the taxing of corporate profit. Once you accept progression then must look to what is reasonable progression. Surely a flat rate of 20 per cent on X dollars and 52 per cent on every other dollar makes no sense at all by any reasonable progression.

It is like the suggestion that we tax everybody up to $10,000.00 at 20 per cent and everything over that at 75 per cent, which is an ignorant view.

There is no way in which one can rationalize what we are now doing except in a roundabout way when it was first introduced that the divdend tax group happened to be linked to the low corporate rate or was intended to be linked to the corporate rate at that time; so that we are not proud of this, as Mr. Simonton says. All we are really saying is that if we must

retain progression, then let us make it progression and not a flat jump.

THE CHAIRMAN: If I may say so, Mr. Stewart has been attempting to define a separate group of companies which are private or small or who would be thought of as deserving of reduced taxation for some reason and taxing others at a greater rate of tax.

If they were taxed at 20 per cent as they are now and everybody else was taxed at a higher rate, would that be what you speak of under the heading of progression or would that be something different?

MR. LITTLE: No, it would be something different, I think, Mr. Chairman. We do not see any way in which you can set up a separate class of taxpayers who will be entitled to one set of rates as opposed to the public.

In our view if it is the rate of taxation for corporate income -- who owns the corporation makes no difference with the exception; as we say, if a corporation is so small it would have to be lower. If it were not incorporated then you have that option so there is no unfairness; but having said that then we say that once you start to tax corporate income you tax it as such. You forget the class.

We do go on, Mr. Stewart, as no doubt you know, and it comes to this under the dual rate. We think if it is retained there should be a completely new theory of who is entitled to the lower rate.

What happens now is that one individual who owns two businesses gets one low rate. It seems to

be the suggestion it is the individual who is being taxed but that is not the approach that is taken in the application of the tax.

It seems to me quite wrong that a person who owns two small businesses, one of which competes with your one small business, should not pay the same rate as your one small business so, we think something like the American approach should be considered, if it is retained.

MR. LEACH: Mr. Chairman, before we leave paragraph 65, as we seem in danger of doing, I would like to say that I am ashamed to admit I have not examined the arithmetic in this formula. I am almost in the position of asking Mr. Little. But essentially the wording here is the effective rate. It is not a true graduation. If it is the effective rate, perhaps you would not get the result Mr. Stewart had suggested.

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THE CHAIRMAN: I follow what you say, I believe, that the existing rates here are not marginal rates.

MR. LITTLE: It is effective.

MR. TOWNSEND: I think it is an ungraduated rate. On the next $1,000.00 of income -- I was making a calculation last night, if you take it as being the effective rate, $1,000.00 earned from $63,000.00 to $64,000.00 would be taxed something like $1,170.00 so it doesn't seem reasonable to do it at the effective rate. It is really a marginal rate on the next $1,000.00 if it is going to work at all.

MR. STEWART: Taking it then on the marginal rate basis, is it not a fact that it is the larger corporations or the larger corporations as a group which are going to be the principle beneficiaries. There are going to be a great many large corporations that are going to have their taxes reduced and none of the very small ones are going to get any reduction at all and there may be small ones that get part of this benefit.

MR. TOWNSEND: That is correct.

MR. STEWART: Well now, Mr. Little, you referred in certain parts of your submission to associated companies. I should make the point now, I am sure it is, perhaps, self-evident that there will be a great many portions of this submission which solely because of lack of time we may not comment on or ask questions about but I assure you that there will be no portion which does not receive consideration by the

Commission staff. Going back to this ---

THE CHAIRMAN: You might say by the Commission. We have all read it and will certainly continue to consider it.

MR. STEWART: Going back to this class of small businesses that you think should, perhaps, be entitled to elect to be taxed as partners rather than as corporations I take it that your figure of 10 shareholders is a purely arbitrary figure.

MR. LITTLE: That is correct.

MR. STEWART: Your requirement that a company concerned may only have one class of issued and outstanding shares is simply for purposes of simplicity.

MR. LITTLE: No, to prevent abuse.

MR. STEWART: Well now, Mr. Chairman, I don't think it is necessary for me to ask any further questions on this particular chapter which is Chapter 3.

THE CHAIRMAN: I am sure we will have some here.

COMMISSIONER GRANT: Talking about the dual rate and the desirability of getting away from the dual rate. I just thought I might ask you while the opportunity affords itself as to what your reaction would be to a triple rate whereby you would maintain the present 21 per cent on the first $35,000.00 then you would increase quite considerably for a small amount, say for the next $15,000.00, but then you would drop it considerably for the balance over the $50,000.00. My thinking is that if you increased it drastically in the second stage for a small amount you would then not be

killing the incentive because once you get beyond that amount you would be back into a much lower bracket, and might such a thing as that get away from the associated companies?

MR. LITTLE: Well, I must say we didn't consider it, Mr. Grant. Your suggestion is that in stage three that the rate of tax would be lower than either?

COMMISSIONER GRANT: Not lower than either.

MR. LITTLE: Lower than stage 2?

COMMISSIONER GRANT: Oh, yes.

MR. LITTLE: So that the incentive would be to move the corporation through stage 2 and not pause.

COMMISSIONER GRANT: Yes.

MR. TOWNSEND: As long as the rate at stage 2 was a higher than the rate at stage 1, which I assume it was going to be in your example, there would be the incentive to disassociate companies, so you wouldn't have the associated company problem cured.

COMMISSIONER GRANT: It wouldn't eliminate the disire to disassociate but it might reduce it.

MR. TOWNSEND: It might in some cases.

MR. LITTLE: It might cause a company that was going to fall into stage 2 to split itself up.

COMMISSIONER BEAUVAIS: Just one question, Mr. Little, why restrict it to a certain number of shareholders? Would you have any suggestion to opening that to any number of shareholders?

MR. LITTLE: Well, we were seeking for simplicity of administration on the one hand. I must

admit that as Mr. Stewart has suggested the figure of 10 is quite arbitrary, but it seems to us within that limitation one would likely encompass the great majority of the small privately owned companies or family corporations that we thought would need the benefit. If you extended it to a thousand shareholders or 25,000 then conceivably the Bell Telephone Company instead of paying 52 per cent would divide the whole thing up an pay a rate as though they were an orphan. This seemed undesirable from the revenue viewpoint as well as the administrative viewpoint.

COMMISSIONER BEAUVAIS: I don't think this would occur, though. Any number of shareholders that would be put there, it would be the same thing, the next one wouldn't be eligible. I am quite sure that would take care of that.

MR. LITTLE: Possibly, I say we must admit, Mr. Beauvais, this is an arbitrary selection and we were simply seeking these two things, simplicity and administrative convenience.

COMMISSIONER PERRY: I was just going to ask, granted you don't like the idea of reduced rates at all; whether you consider some way of applying a corresponding alleviation to business carried on other than in corporate form.

MR. LITTLE: Well, we, of course, in a general way did. We weren't pursuing that as an alternative, but in the course of our discussions we did, of course, compare the position of the man who is in business with the man who is salaries or a wage

earner. This man is one of the reasons that we objected to the dual rate. We could see no reason for the man who earns $15,000 salary paying more tax than the fellow who owns the business and makes $15,000 income, which he can do.

COMMISSIONER PERRY: What about some sort of concession for the sole proprietor who is, as you know very well, taxed at graduated personal rates?

MR. LITTLE: Quite right. If our conclusion had been that we ought to retain the dual rate system or if it was likely whether we recommended it or not this is what we came to, then I think this would have been the suggestion we would have put forward, that the individual in business, the proprietor ought not to be in a different position than the person who is able to incorporate. This certainly applies to our profession.

THE CHAIRMAN: Presumably you considered whether or not there ought to be a different rate of corporation tax applied to distributed and undistributed earnings. It has been said from time to time that the present system encourages abuses. What is meant by that is possibility of release of accumulation by way of tax gains. Did you consider whether or not there should have been a separate rate of tax or different tax on distributed or undistributed?

MR. LITTLE: Yes, we did, and we recognized the point that you make, Mr. Chairman, and we believe that we solved this in our suggested method for taxing on dividends so that the real incentive to accumulate is no longer there. This incentive to accumulate, of

course, really applies once again to the closely held businesses where the major personal shareholders would pay a very high burden of tax if the money were distributed. We don't think it applies to the widely held corporation where the rate of return that is demanded by the market place must be met or the people simply don't invest.

THE CHAIRMAN: I can understand the two problems with the private company, but what you say with regard to the public company, I find much more difficult to accept because to the extent thepublic company accumulates earnings it must be roughly to about helf of their earnings. Surely this is one of the qualities that enhances the value of their company's shares. It is not the only reason, but it is important. If this is so the shareholder gets benefit of that by eventual sale of his shares which under our system is untaxed. That being so does he not get a clear benefit by accumulation? It is true he doesn't call the shot as to whether there is accumulation but if he holds on to his shares in the ordinary course I would think that to the extent there is accumulation he gets the benefit through distribution; am I not right?

MR. LITTLE: Well, yes. To state it as simply as that, that might be so. I think, Mr. Chairman, if we take any representative number of companies and look at the past history in the past 50 years to see what has happened as a result of the accumulation I think our conclusion would be this was the right thing to have done because in the first place it has

allowed industry to expand, it has provided facilities for the country. It has provided employment, and also while one may say the earning power of the individual was left on deposit and reinvested, and he didn't take it out to pay taxes, if you look at the value of the investments today, what he was taking out in the way of income, it has multiplied many times, and itseems to me this is the goose that is laying the golden egg. If we discourage accumulation the disadvantages would far outweigh anything that would be accomplished by distribution.

THE CHAIRMAN: You are not justifying it on the basis of neutrality, which is where I started, to find out if there wasn't any bias of one to the other, distribution as against undistributed. You are justifying it on the basis of good economics. Such it may be, I don't know. One other question: You make the point that incentives represent a subsidy from one taxpayer to another taxpayer, and you suggest rather than incentive forms of taxation, that there should be other benefits given by way of financing of small companies, assistance in establishing plants or something like that. Is that not exactly the same thing? Isn't that a subsidy or one taxpayer to another?

MR. LITTLE: No, I don't think so. In the case of an incentive -- take the situation you mentioned a moment ago, where, perhaps, the real cost of the incentive to the new corporation is going to be a penalty that is placed on one taxpayer or two or three

small taxpayers within a group of taxpayers. It seems to me that the subsidy, incentive approach does by reducing this person's tax burden increase other tax burdens. Up to the extent it is -- yes, I can see I am driving myself into a corner, I get back to the point where it is part of the tax revenue. I suppose our real objection to this is you can't measure it and you don't really know who is paying it.

THE CHAIRMAN: I think that is a very significant, important point. I was curious as to the difference of the transfers as between the two. I don't think there is any.

MR. LEACH: Oh, yes. Taxation should be used to raise revenue. It shouldn't take money from one taxpayer and give it to another, take it from one citizen in one capacity and give it to another citizen by means of government assistance of any sort. I think that is what Mr. Little meant originally.

THE CHAIRMAN: It may be done within the framework of our total fiscal policy.

MR. LITTLE: Here the total revenue has to be X dollars and you fail to tax somebody, give him an incentive, all the remainder must bear the rest.

MR. McMACKIM: Is it not true, Mr. Chairman, if the assistance is in the form of loans from the provincial government they will amortize their costs so the outlay to the taxpayer there is temporary. In other words the industry, if the industry is successful they will recover out of their earnings and thus plow back to the revenues, to the country.

THE CHAIRMAN: So is a tax holiday only temporary.

MR. McMACKIN: There what you have allowed is gone forever, isn't it? Here it seems to me, this type of assistance, the money eventually comes back to the Crown through amortization of the loan, the loan that amortizes. The loan is repaid. When you take it from one taxpayer and give it to the other it is gone forever as far as the losing taxpayer is concerned.

THE CHAIRMAN: It may be gone from one taxpayer forever but it is received by the other forever.

MR. McMACKIN: That is what we describe as being unfair and improper in the taxation Act.

THE CHAIRMAN: Thank you.

COMMISSIONER PERRY: I am a little bit surprised that accountants only just discovered that incentives are discriminatory. I assumed twenty-five years ago by their very nature they are discriminatory, that the value to be served sometimes warrants a degree of discrimination. It sounds to me in Mr. Little's example the results desired have been achieved completely.

THE CHAIRMAN: The plant was moved from the one location to the depressed location.

COMMISSIONER PERRY: Which is exactly what was intended.

MR. LITTLE: Mr. Perry, with great respect surely the government didn't intend that. Surely they intended new industry.

COMMISSIONER PERRY: Why would they pass

such legislation if they didn't intend it.

MR. LITTLE: Mr. Perry, if we had time I would like to discuss it with you. I don't know.

THE CHAIRMAN: Mr. Little, I think there is one point of importance. I don't want to labour that illustration. Surely incentives must by their nature be discriminatory. They are intended to be discriminatory I think. I think this is important because it seems to me the way we must approach our job is first of all to try to decide what is the income appropriate to each industry where there is no discrimination and where is the proper income to be taxed. Having done that one must look at the Act, at the discriminatory clauses, taking away from one group and giving to the other and trying to decide whether there is a balance. Mr. Leach said the purpose of the Act is to raise revenue. We all accept that. There is no doubt the Tax Act has for a long time been used for additional purposes to that. I would be very surprised if you say it should not be used in any circumstances except to raise revenue.

MR. McMACHIN: You are quite right. We did come to the conclusion. We feel it should be used sparingly and for purposes of very serious need and whatever incentive or special concession is allowed should terminate promptly when the need is met.

THE CHAIRMAN: Thank you.

COMMISSIONER PERRY: This question as to whether discrimination is justified is wide open, but it is there, there is no doubt.

MR. LITTLE: Yes, but I think we ought to

distinguish very carefully between incentive and discrimination that applies to a particular industry, for example. Incentives to a particular industry to get started, to keep moving -- those incentives may operate in an unfair fashion between existing taxpayers. For example, a tax incentive to those who export, for example, is a discrimination against the person who may become efficient and produce locally and block off the market. This is the sort of thing that creates discrimination across the board. This, I think, is quite different than saying that a new mine, for example should have a three year exemption, all new mines have three years exemptions. This doesn't affect any other particular industry, but it does, of course, affect the total revenue and all taxpayers share equally in attempting to establish a particular industry.

THE CHAIRMAN: They tell us it affects the distribution, allocation of reserves, distribution of facilities.

MR. LITTLE: I would prefer not to discuss that hardacre theory.

COMMISSIONER GRANT: In this field of assistance it has been suggested to us that anything in the nature of a capital grant by way of loans or by way of plants, all capital expenditures should be restricted to the provincial government and if that were done that there could be some relief given by way of accelerated depreciation under the Income Tax Act that would have more meaning and might result in achieving the

end, more effectively. Would you have any views on that?

MR. LITTLE: I certainly must recognize the provincial arguments that prevail here, unless that sort of assistance is left to the provinces then once again we are not equal between one another. I think perhaps it is more fair and reasonable provinces should do it if they like.

THE CHAIRMAN: Anything else on this section? Shall we move now, Mr. Stewart, to chapter 4?

MR. STEWART: Gentlemen, I would like to ask some questions on this chapter having regard in particular to the problem of surplus stripping. Some of my questions have, I think, been touched upon already. Would you consider that in the basic prerequisite to surplus stripping is accumulation of surplus in corporations, which surplus is taxable on distribution?

MR. LITTLE: In part. The rate of personal tax is the other fact. If there was no personal tax it wouldn't be a problem.

MR. STEWART: If there were no personal tax it certainly wouldn't be a problem, but does the progressivity of the tax not simply accentuate the problem.

MR. LITTLE: Yes. We wouldn't say it simply accentuates, but it is the problem in our view.

MR. STEWART: The problem would exist if there was a surplus and a flat rate of personal tax, would it not?

MR. LITTLE: Yes, but to a much lesser extent.

MR. STEWART: This accumulation of surplus, I take it may be motivated by a number of considerations, one may be the desire to have the business expand, another may be to avoid the personal tax which would be payable on the distribution of the profits.

MR. LITTLE: Yes. I believe to keep it in a proper perspective, I honestly think the latter situation is very small in number in relation to the corporations who legitimately expand and grow on accumulated earnings. I think basically that the motivation of growth and expansion is far more important in corporate actions than avoidance of personal tax.

MR. STEWART: The desire to avoid tax, if it exists at all may, perhaps, be more likely to be found in a case of closely held corporations.

MR. LITTLE: Yes.

MR. STEWART: Have you considered in your deliberations whether we should have legislation in this country directed against the unreasonable accumulation of profits?

MR. LITTLE: We devoted a great amount of attention to that problem. Perhaps my colleagues would help me on this. We are certainly mindful of the difficult problem that arises as to the measurement and we therefore feel either some arbitrary rule has to be adopted or some discretion introduced. I think it is probably fair to say we shyed away from this approach for this reason and for the difficulty we saw in such a discretionary approach.

MR. STEWART: I believe legislation of this nature does exist in countries like the United States, the United Kingdom, Australia and South Africa to name four.

MR. LITTLE: I am quite prepared to accept that statement. I am not familiar with the countries other than the United States.

MR. McMACKIN: If I could interject a word, I recall a discussion we had in which we felt that in Canada the pattern of financing is different than you find in those countries. As the Chairman remarked a few minutes ago about half the corporate profits generally have traditionally been retained and used for development. This is a healthy situation in a country that desires the building up of ownership of its own business by its own nationals. If you distributed that or forced people to, a good deal of it probably would go back into the equities of Canadian companies. I think that any tax of that kind besides being very difficult to adminster except on some very arbitrary basis would tend to upset what has proven generally to be a satisfactory pattern of Canadian financing, Canadian corporate financing.

THE CHAIRMAN: Mr. Stewart, you are thinking of moribund companies that are lying all around the country which companies are not operating and this has been set aside by some means so it is not liable to tax.

MR. STEWART: That is one type. There are companies which are engaged in a particular industry who have accumulated very substantial investments, say

foreign companies, which have considerable holdings that are not being devoted to carrying on that form of operation in that industry. These are examples. I am raising the question generally. Your solution to the problem of surplus stripping, in any event, is clear cut, your recommended solution is clear cut from your statement. You indicate that you consider any solution which is arrived at must be reasonably equitable in all situations, and then you say that you think there should be uniform taxation of all distribution of corporate earnings. I would like to ask you on the second proposition whether your solution of 15 per cent flat rate tax does produce equity in two situations which I would like to mention.

The first is between the shareholder in the widely held company and the shareholder in the closely held company. The reason that I question whether this is an equitable solution is that in ordinary circumstances the shareholder in the widely held company has a market for his shares. The shareholder in the closely held corporation may not have a market. Certainly he hasn't as free a market. When we have a flat rate of tax the shareholder in the widely held corporation must sell or attempt to bring about distribution. The one in the closely held corporation may not have the two alternatives. He may be forced to distribute.

MR. LITTLE: That is the present situation. I would say if the small fellow must distribute then his position is infinitely better under this proposal as it otherwise would have been. It puts him much more

on par with a person who sells his shares. The person who would sell his shares under the new scheme could sell his shares today.

MR. STEWART: Whether he could sell his shares or not you say that the person who could sell his shares today under the present arrangements could sell them under the new scheme as well, quite right. Well now, under your plan where the flat rate distribution may be made is there not a difficulty of preferential treatment to the high income shareholder?

MR. LITTLE: Yes.

MR. STEWART: Now, when under your plan you impose a flat rate of tax on distributions this will clearly reduce the incentive to strip surplus and the maximum tax that could be avoided will be 15 per cent, but if there are people who would like to avoid the 15 per cent tax and who are ingenious and have ingenious advisors doesn't the problem remain?

MR. LITTLE: That depends entirely on the extent of our ingenuity. Our conclusion is we have blocked the avoidance.

MR. STEWART: This is blocking not through the 15 per cent rate but through the steps that you suggest with regard to non-resident companies and so on.

MR. LITTLE: That is correct.

MR. STEWART: If these loopholes can be plugged in the way you suggest can they not be plugged today without the 15 per cent tax at all?

MR. LITTLE: Yes.

MR. STEWART: Is another result of your plan not to penalize distribution by companies to corporate shareholders where there is no thought on the part of the recipient of passing the dividend in question on?

MR. LITTLE: Well, that is a perfectly valid criticism, that if for some reason it was necessary to operate the corporate complex through a number of companies the imposition of the 15 per cent tax on the first movement of a dividend would, of course, result in 15 per cent withdrawal of this tax at the time the funds moved. Were it possible for a company in such circumstances to operate their profits in some fashion, perhaps by loaning funds, that wouldn't be a penalty. Frankly we did consider this very carefully and our conclusion really was this wasn't a serious area, that corporations would probably not get in this position. If it became a serious problem I think you could amend our proposal in some fashion to permit the distribution of dividends within a wholly owned corporate complex without tax until such time as it moved out. I think, perhaps, Mr. Chairman, I should suggest that these questions be directed to Mr. Bruce Philip. I think we should acknowledge here is the architect of this plan. As I mentioned we devoted more time to this problem than every single problem that faced us in the tax area. Of all the solutions we considered this was the one that emerged as the best solution all around, and it was presented to us very early in the game by Mr. Philip and in the end result we found ourselves coming back to it time and time again. We

couldn't find a solution that was better. Mr. Philip is really the expert on this matter.

I might also say we didn't get this from the Special Committee of Parliament. We came to this conclusion before they made their report.

THE CHAIRMAN: This is most interesting to us because, like yourselves we find it the most serious area we have to deal with, certainly one of the most difficult and you have given us something here very useful indeed. We would like to proceed further into it.

MR. STEWART: Under this plan if we are still, theoretically, at any rate, exposed to the possibility that attempts at surplus stripping will occur, and we proceed to block loopholes that you mentioned, the existing loopholes in the way you indicate, is there not a definite possibility that we are still going to need some general anti-avoidance measure directed against surplus stripping of the sort which now appears in Section 138a of the Act?

MR. PHILIP: We don't really feel so. As a committee, to the best of our ability we attempted to find loopholes in the solution and as of yet other than the one we felt we covered - I don't think that the committee agreed that we should retain the type of legislation we now have in this new section. It is a broad approach and the effect it has is of restricting what might be considered normal business transactions but which are not in any way an attempt to strip surplus, but merely to rearrange corporate situations.

MR. STEWART: Have you considered in this regard, Mr. Philip, the experience in other countries because I am informed in a good many other countries where surplus stripping has been developed the experience has been that some general anti-avoidance legislation is necessary.

MR. PHILIP: I think we did look at some other countries. I know that Australia has legislation of this type. Possibly we would need it in Canada, but it would seem unless the problem did develop after the enactment of this type of legislation, at least, at the outset it wouldn't appear to be necessary.

MR. LITTLE: I would like to reinforce what Mr. Philip is saying and refer back to the number of principles that we adhere to in our presentation, and one is certainty and clarity in the law. We find that section 138a is completely foreign both to the principles we embrace and the way we must conduct our professional practice. In our view it would be better to leave the loopholes unplugged and plug them as you find them one by one with specific legislation rather than to introduce in the Act a broad sweeping discretionary power that brings into question not only the stripping situation but almost every conceivable form of corporate organization in the country.

MR. STEWART: Let me put to you the section of the Australian Act which applies, not simply to surplus stripping but avoidance of taxation. I think you will find it is not based on discretion at all. It reads as follows:

"Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall in so far as it has or purports to have the purpose or effect of in any way directly or indirectly, defeating, evading, or avoiding any duty or liability imposed on any person by this Act, be absolutely void as against the Commissioner or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose".

This is extremely general terminology and obviously very specific terminology would then be equally important to you as Section 138a.

MR. LITTLE: Well, the Committee didn't consider that very provision. My personal reaction is it is absolutely as important as 138a. In wording such as that you are paying a fine for paying your taxes on time.

MR. STEWART: When we have a provision such as Section 138a or such as the Australian section, perhaps I should say if we have rather than when we have, if we have such a provision would there be something to be said in your view for enabling taxpayers to apply for advance rulings which will be binding on the

authorities on matters which can conceivably be affected by the provision.

MR. LITTLE: Yes, indeed, and we make this recommendation.

MR. STEWART: In your consideration of this overall problem have you given any thought to this type of plan which is based on the assumption that the corporate rate and the top personal rate of tax are close together, that there be one ordinary corporate rate of tax, and then there be a special corporate tax or undistributed earnings which would be equal to the difference between the ordinary corporate rate and the top personal rate? It would be a further feature of the system that earnings which were retained after the special corporate rate had been paid would be what we call tax paid on undistributed income. I don't know if I have described clearly enough that basic plan or whether you have considered such a plan.

MR. LITTLE: Well, I assume that any such plan would have additional features, I assume. Is the individual recipient allowed to offset for the corporate earnings?

MR. STEWART: The individual recipient of the dividend in a particular year paid out of earnings of the year pays tax on that amount in the normal way. In fact what happens is that earnings which are distributed in a particular year are taxed at this special rate, between the top personal rate and the ordinary corporate rate and very often those earnings can be distributed free of tax.

MR. LITTLE: I assume that this question must stem from a program that has other features attached to it. Taking it simply as is this would mean if the top corporate rate was 60 per cent -- corporate was 40 per cent undistributed, the rate on such earnings would be 20 per cent, and this would create the incentive to accumulate the income and leave it in the corporation at 60 per cent rather than have tax at 40 per cent and tax at 20 per cent which would be an effective rate of some 80 per cent. That is why I ask if there isn't some further features. A plan such as that would defeat the purpose you strove to accomplish.

MR. STEWART: Well, Mr. Little, this paln, if you assume rates of 40 per cent and 55 per cent isn't dissimilar, it seems to me to yours. If we have a corporate 40 per cent rate and a special rate of 15 there is a tax of 55 per cent on undistributed income. It seems to me that the difference between the two is that under the scheme I have just suggested to you there could be no benefit to the taxpayer in the high brackets because there is no advantage to him in having income accumulated.

MR. LITTLE: That is why I asked whether there would be any corporate offset on the difference. If he has a personal rate of 55 per cent and no offset on the corporate rate, then the corporation has paid 40 per cent and it comes to him with no further corporate rate, but he pays 55 per cent. If he leaves it inside the corporation the combined rate is 55 per cent.

MR. STEWART: Let me give you an example. I

am not sure whether I have explained this properly. Supposing we have a corporation which has pre-tax income for this year of $1 million. The ordinary corporate rate is 40 per cent, but suppose the corporate rate I mentioned is 20 per cent and the tax individual rate is 60 per cent. Let us take the shareholder, let us suppose, to make it easy that we have a shareholder who owns all the shares in this particular company. One of his options is to distribute the whole million dollars by way of dividends in which event he is taxed at 60 per cent.

MR. LITTLE: Forty per cent corporate rate distributed, $600,000.00 -- $360,000.00 worth of taxes, $220,000.00 net, and if he leaves it in the company he has $400,000.00 net.

MR. STEWART: Yes, I think to make this intelligible I had better amend it by providing that dividends are deductible in the computation of corporate income.

THE CHAIRMAN: Dividend tax credits.

MR. STEWART: Dividend tax credit of 40 per cent.

MR. LITTLE: If we move off into the area of deductibility of dividends we can explore it further if you wish -- we did consider it. We decided against it for a number of reasons that we discussed this morning, I think, or early this afternoon. We wouldn't find this an acceptable plan.

MR. STEWART: Well now, Mr. Chairman, this is a very brief treatment of this chapter on corporate

distribution but I think I have covered the basic points I wanted to cover.

THE CHAIRMAN: I have a few points and I imagine everybody else has too. This solution which you put forward depends on a flat rate, distribution rate, I believe.

MR. LITTLE: Flat corporation rate and distribution.

THE CHAIRMAN: Which you suggest is 15 per cent. Do you feel that a graduated distribution rate wouldn't be good?

MR. STEWART: Well, the special committee, Mr. Chairman, must have come to the conclusion it couldn't be workable with the dual rate. We don't think it works very effectively, but we discussed the dual rate for other reasons. We didn't discuss the dual rate in this scheme. In our discussions we had come to the flat rate.

THE CHAIRMAN: Have you computed the difference at different levels of income, investment income on shares and ordinary earned income that is taxed.

MR. LITTLE: We did it. I am afraid we haven't any computations with us. I cannot quote them to you. All I can say is they didn't dissuade us from the propriety of our solution.

THE CHAIRMAN: I would have thought there might be a very wide difference of the extremes of income. Probably at the low income there would have been quite a difference between ---

MR. LITTLE: At a low income it is conceivable

there might be more tax under this scheme and that is why we are suggesting without formerly recommending it might be desirable to retain the 20 per cent dividend credit and give an optional system to the small shareholder, small income earner so he would be in no less favourable a position than he is today.

THE CHAIRMAN: On the other hand this is very difficult because our system is committed to a graduated rate of taxes on persons and you are not saying the graduated rate is not correct. You are saying to solve it we must retain graduated levels. You don't wish to stop graduation on ordinary corporate rates either. You say we should move away from this in this particular case. Is there any reason why you move away from it or just because you can't find a suitable answer to it and preserve graduation.

MR. LITTLE: I think that one must admit that that has a bearing upon the solution that we came to, Mr. Chairman. There are other reasons. In the first place there is no revenue produced now from dividends, a tax on dividends on the high bracket incomes. Consequently there is so much avoidance going on that we wish to plug, that there is an immeasurable factor here of revenue lost that ought to be recouped. Thirdly we think this is a great attraction so far as an investment by Canadians in Canadian enterprises is concerned. Fourthly, of course, the end result is the tremendous simplicity in the Act in its administration, and finally, of course, collection of tax at source which we feel will pick up income that is now escaping tax

entirely, and also get it sooner.

THE CHAIRMAN: The collection at the source could be done irrespective of what you are now proposing?

MR. LITTLE: Yes.

THE CHAIRMAN: You would treat it somewhat differently than it would be treated under the present system?

MR. LITTLE: Yes.

THE CHAIRMAN: In recommending a flat rate tax, I think it is essential to recommend because of the practicabilities of your solution.

MR. LITTLE: And the effects on revenue which is very small.

THE CHAIRMAN: There is no philosophic argument in favour of flat rate tax on this or any other income.

MR. LITTLE: Yes.

THE CHAIRMAN: Not personal income.

MR. LITTLE: Yes.

THE CHAIRMAN: Let us have it.

MR. LITTLE: I think a flat rate tax applied to personal income is perhaps the fairest measure of ability to pay.

THE CHAIRMAN: I thought you deny that somewhere else. You are advocating this yourself and not as Chairman of the committee?

MR. LITTLE: No, sir. I am distinguishing between ability to pay and equity of sacrifice. This is a philosophical differential. I think a strong argument for a flat rate of tax is it would increase

the amount of income, in fact, it is an obvious measure of ability to pay. In this country, and this is the reason we have accepted a measure of progressivity, we think equity of sacrifice requires a different rate at higher incomes.

THE CHAIRMAN: Having regard to what is left over after taxation.

MR. LITTLE: Yes.

THE CHAIRMAN: Surely if you have regard to that in the general scheme in taxes you must have regard to it here, do you not?

MR. LITTLE: That is correct. You are perfectly right. We are departing from the principle in order to capture some other disadvantages which to us are very important without very significant revenue loss.

THE CHAIRMAN: If the other six could be achieved adhering to the principle you would have thought that preferable because you agree with the principle.

MR. LITTLE: That is right, but we found we couldn't solve it that way.

THE CHAIRMAN: One matter I touched on before is that, I think it has been the experience in the past that one means of avoiding tax on the distribution of income is to simply pull the assets out of the company and leave the surplus there, and one does that by some form of loan or investment and one might refer to that as a moribund surplus, companies that have ceased to be active and have no real active

assets at all. I think there are a lot of those companies in Canada. In my own experience I have seen several. I imagine if I have seen several there are a great many. This being so, with regard to these companies, your proposal doesn't in any way take care of that.

MR. LITTLE: We think it does, Mr. Chairman.

THE CHAIRMAN: Do you?

MR. LITTLE: We have reference to a business ending and not having new business within a certain time but the distribution would have to be done and the tax levied.

THE CHAIRMAN: What paragraph?

MR. LITTLE: Paragraph 92 on page 30.

THE CHAIRMAN: Is this taken care of by the words "wound up or discontinued"?

MR. LITTLE: Yes.

THE CHAIRMAN: I suppose it gets down to when is a business discontinued. Don't we have something like that in the Act at the present time?

MR. LITTLE: I think on the distribution in Section 8 this would impose a tax whether or not there was distribution at that point.

THE CHAIRMAN: In order to achieve what I speak of that has been done in the past it will be necessary to provide some method of avoiding discontinuance of the business.

MR. LITTLE: That is right. A provision such as this could be adopted in the present scheme of taxation, as a matter of fact a flat rate of tax, or

such as 105c - it would stop some of these things you are suggesting are going on.

THE CHAIRMAN: Thank you.

COMMISSIONER BEAUVAIS: Have you estimated the loss of revenue to the government through this proposal?

MR. PHILIP: We estimated loss of present revenue would be approximately $30 million. We couldn't tell what the increase in revenue would be, current revenue we are obtaining on tax on corporate income, corporate distribution, income now in the personal tax returns.

COMMISSIONER GRANT: Your discussing the retention of earnings reminded me of an allegation that I have heard made. I don't subscribe to the truth of it, in fact, I don't know if there is anything in it. I thought I might ask if you or any of the witnesses here today have had experience in this or know if it at all. The allegation was that subsidiary companies of foreign owned parents operating in Canada allow earnings to accumulate and retain them in their business to the detriment of their Canadian competitors.

MR. McMACKIN: I don't think I am a suitable person to answer this. It should be someone who has a wider knowledge of international transactions.

MR. LITTLE: Mr. Grant, I don't think that the accumulation of funds here and reinvestment per se acts to the detriment of Canadian competitors. If we didn't wish to have foreign control then the original capital should not have been allowed to come. It seems

to me that if a foreign tax company establishes a prosperous enterprise in Canada then, surely, if we wish it to be here we should wish it to prosper and expand, provide employment and feed the market. If this is detrimental to Canada then it is detrimental to Canada in the sense that we had capital that couldn't have gone into the business and we did't put it there. I don't think this is important. Surely over the last X number of generations the problem in Canada has been lack of capital and it has been foreign capital that made our growth possible.

COMMISSIONER GRANT: I won't labour the point, Mr. Little. I think your answer is, perhaps, the right one. I think that the remark that were made to me was largely based on the fact that Canadian capital is harder to raise. It goes out and it raises its own capital on the market either through equity financing or through debt financing and it finds its competitor with a large rigidly subsidized or rigidly owned competitor whose ownership is outside of Canada who doesn't have to pay out any funds to its plant, whereas the Canadian counterpart is obliged to because it has raised its capital through debt and public financing. I am personally satisfied.

COMMISSIONER PERRY: I was re-reading paragraph 83. I find it a little puzzling. The second last sentence:

> "The special provisions of the Income Tax Act along with the obvious loopholes in the laws have

encouraged so-called surplus stripping."

This confuses me a little because the imposition of the special provisions have had the effect of levying a graduated rate and one would have thought this would have encouraged the use of special provisions rather than of dividend stripping?

MR. LITTLE: Except special provisions themselves have opened up loopholes through which you can walk, special provisions such as 105C. The mere attempt to solve this problem by special provisions has had the effect of producing loopholes.

MR. LEACH: Designated surplus costs have special provisions, and it in turn opens up loopholes.

COMMISSIONER PERRY: These were frills on other loopholes, if that is what you would call them.

MR. SIMONTON: You have to remember Section 105 doesn't apply to very large amounts of surplus in the hands of any companies. One sees it all the time, having paid tax at forty-nine on undistributed income quite cheerfully and having matched dividends under 105-2 there still remains a heavy amount of surplus that can't be got out except under 105C, which I think today, in the light of the recent amendments everybody would be afraid to use, even though they came directly within the terms of it. There are great surplus accumulations. I might say the more time goes on the more bad this will become. If a company is in the habit of retaining half its income -- Section 105 doesn't provide the solution for more than a very small part of the

difficulty, and in the case of newer companies it provides them no assistance.

COMMISSIONER PERRY: I think that there is no basic difference in our understanding. It is the way the paragraph was worded.

MR. LITTLE: I don't think when we used the words "special provisions" we were restricting ourselves to the special provisions that permitted the withdrawal of flat rates -- there are other special provisions in the Act such as mortgage provisions which have opened frightful loopholes.

MR. TOWNSEND: I think we must also remember 105B and tying in 105D has tended to encourage that type of thing. I think looking at that sentence in that particular way, I think it does make sense.

THE CHAIRMAN: Any further questions? We will stand over for ten minutes and go on until 5:30.

---A short recess.

THE CHAIRMAN: Mr. Secretary, are we ready? We are going to, at this stage, change pace a little bit and move to a different part of the submission. Before that I would like to say that our staff has been examining several schemes of tax on corporations and on the distribution of corporate income. I would imagine the number might be 12 or 15. There are a great variety of them. There are a lot of ways this might be done. Certainly what you proposed to us will not be overlooked but it will be fitted right into the comparison and it will be examined very carefully indeed.

This may be the best of all, I don't know. It is certainly one of the alternatives, and a very important one of the alternatives and will be given careful weight along with the others.

What I would like, if it suits you is to move from chapter 4 which I think we just completed, there is nothing more on chapter 4, to chapter 7 on page 45. The reason for that is we asked Mr. Coyne to prepare himself with regard to chapter 7 and all thereafter. We asked Mr. Stewart to prepare himself up to Chapter 6, but unfortunately Mr. Stewart could not reconcile his questions on chapter 6 with his plane time. He has left us with two chapters, 5 and 6 to do. I would like to leave over 5 and 6 to tomorrow morning and in the meantime we Commissioners will prepare ourselves and have questions to put to you with regard to these two chapters the first thing tomorrow morning. In the meantime we will proceed with Mr. Coyne from chapter 7 on. For those of you who haven't seen Mr. Coyne, he has been in court, I would introduce Mr. Jack Coyne who is legal advisor and counsel to this Commission and will carry on with these questions. Mr. Coyne.

MR. COYNE: Thank you, Mr. Chairman. Mr. Little, at the outset of chapter 7 you state the Committee's conclusion that the present system of taxing personal income is basically sound and in most cases equitable, and then indicate certain general views on two particular aspects of the system of taxing personal income. The first of these is that in the higher income

groups it may be so great as to dull initiative and as a result be detrimental to the economy as a whole. You refer to this in great detail at page 58 near the bottom of the page where you state:

> "The Committee feels that the top rates of personal income tax are so high that they may act as a stifling influence on personal initiative and hence may actually reduce the flow of tax revenues".

After further comment on that aspect of it and also the relationship with the United States you suggest that the schedule of rates of tax on individual income be carefully reviewed and that consideration be given to setting the top rate of tax at approximately 60 to 65 per cent. The view that top rates of income tax are too high and stifle individual initiative is one which is widely held, and of course has been represented to this Commission by a number of other groups and taxpayers. On the other hand not much in the way of specific or general evidence has been provided to substantiate the view or to indicate the extent to which these high tax rates are detrimental to the economy. Now, my first question is really to ask whether the Committee has any specific evidence which might be useful to the Commission in seeing the type of detriment referred to, and if not relate to us on what the committee based this conclusion.

MR. LITTLE: Well, Mr. Coyne, I must acknowledge

this is a very easy statement to make, a very popular one to make. I think we felt that some importance should be attached to the fact that we make it because none of us suffer from these high rates, and therefore our proposition is, perhaps, somewhat different than other submissions that have been made. It is true there is no way of placing a dollar value on retarding initiative, on what someone might have done had he done something else. However we do think, and we think this is important because the Institute of Chartered Accountants spends a great deal of its time dealing with people who pay taxes and assisting them with their taxation problems and in filing their returns. I would suggest there is, perhaps, no group in the country in a better position than we are of assessing the reaction that individuals have to the burden of personal taxes. Our feeling is there is this retarding effect.

We see it, first of all, in the extraordinary amount of time that is spent by individuals and by their professional advisors both in accounting and in law in trying to find ways to stop what is happening to them or re-arranging their affairs to do something else. Those in this vocation know it is a very costly, serious business. We do think, while people say, of course, you know it doesn't matter it is the prestige of the job, an executive vice-president works just as hard for X thousand dollars as for 2-X thousand dollars -- we don't think this is true. We think with the evidence we see that people who are willing to move from one job to another, for example, in order to better their

financial position is an outcropping of two things, that is the desire for improvement, but also it is a rebellion against the amount of take home that is now available. We see people not only moving from job to job in this country but we see people leaving this country. This we think is a serious factor and we think while our rates of tax may be approximately the same as the United States in those brackets the level of income is higher and the people who move are blaming the move on the impact of Canadian taxation. There is not enough take home pay.

We see this occasionally, not an every day occurrence, but some prominant person who doesn't make the newspapers at all, leaves this country and goes somewhere else because of the impact of taxation.

As I say there are imponderable forces. We cannot give examples of individuals or measure the dollar effect. I think this, perhaps, is a fair summation of the sort of thing we see happening in Canadian economy to people who get into these upper brackets of income. I think it is perfectly true to say that people who reach brackets such as that will stop their endeavours to acquire more or produce more simply because there isn't enough in it for them. I believe this honestly and sincerely myself, and I think it is the view of the whole committee in the practice we see across the country.

MR. COYNE: Thank you very much. You draw the conclusion out of your professional experience as you have described it. Would you care to say why you suggest

that the top rate of tax should be at the 60 to 65 per cent level? Are there any specific reasons for this?

MR. LITTLE: Yes, two reasons, really. First of all we have referred to the revenue requirements and we assume there is some reasonable limits beyond which it is not practical to suggest we go. On the other hand, and perhaps it is because people have been accustomed to much higher rates, it is our feeling rates at this level are more bearable and wouldn't retard initiative and incentive as would rates of 75 or 80.

MR. COYNE: You say this is your feeling, you think the reduction to this level would have a significant effect on these motivations that you have been speaking of.

MR. LITTLE: Yes, we feel so.

MR. McMACKIN: It would depend on how they were applied and the changes made in the method of graduation.

MR. COYNE: This is in graduation up to the top level, not only the top level.

MR. McMACKIN: Yes.

MR. COYNE: On which you are not making any recommendation.

MR. LITTLE: No, except we say here the rate structure will have to be reduced. We are not suggesting as Mr. McMackin said that we simply take the present rate structure and cut it off at 60 or 65 per cent.

MR. COYNE: You are not suggesting that?

MR. LITTLE: We are suggesting that the brackets

change as well.

MR. COYNE: As well, but without spelling out the details?

MR. LITTLE: That is correct.

MR. McMACKIN: Yes.

MR. COYNE: You said that one of the considerations leading to your picking this level had to do with revenue requirements. Have you made any detailed calculations of the affects on revenue of the sort we are talking about.

MR. PHILIP: No, I don't think we really attempted to re-design the rate schedule or estimate the loss in earnings or any adjustments.

MR. COYNE: Let me ask you that, the Commission staff is undoubtedly engaged in just this sort of calculation, but in your judgment is the degree of revenue loss an important consideration in the level at which you stop if you reduce the top level of taxes?

MR. PHILIP: Yes.

MR. COYNE: So if it turned out for example that revenue losses were substantial if the rate were reduced as low as 50 per cent would that leave you to favour an even lower maximum rate than 65 per cent?

MR. LITTLE: Absolutely.

MR. COYNE: The second general aspect of personal income tax that you refer to in this introductory part on page 45 on which you comment is, I take it, the level of personal exemptions in the sense that you state at the end of paragraph 127 that the committee is opposed to any proposal to narrow the Base by decreasing

the number of taxpayers. Again in paragraph 154 on page 54 you refer to the question of exemptions and you state you have not attempted to justify the present level of personal exemptions or to suggest any increase or decrease, but on the other hand by opposing any narrowing of the tax base on page 45 you clearly oppose any increase in the exemption. Is that a fair statement?

MR. LITTLE: I think that is a fair statement. We considered the level of personal exemptions and we really had no fear that they were substantially wrong, too high or too low. They appeared to us as reasonable and we had nothing better to suggest.

MR. COYNE: On the other hand your general position, and I am really taking the brief as a whole in this regard is that the tax base should be as broad as possible allowing for other appropriate factors of equity and the various considerations that should enter into a desirable tax system. I wonder if I could put this question to you since it is a matter that directly affects the tax base. Taking only for the moment the basic exemption of $1,000.00 that is available to all, and leaving aside marital exemptions, and the like, it would be interesting, I think, to have your views as to whether it should be increased, but conversely, and perhaps of greater interest as to why, if you have a view on this subject, it shouldn't be reduced say to $500.00 or eliminated altogether? Is there any justification for a basic exemption that is totally unrelated to the taxpayers personal needs or anything else?

MR. LITTLE: Well, I suppose that we adhere to a basic exemption because of the philosophy that there is a minimum amount of income that is required for subsistance and that until a person has this it is, perhaps, unthinkable to tax him at all. I imagine this is the philosophy behind the whole exemption system. On the other hand while having regard to today's standards and to today's costs $1,000.00 is probably not right today, if it was right X years ago. Nevertheless I think that things have changed to such an extent, there are so many demands made now on behalf of the individual by the Crown that a participation in this burden by everybody we think is better. Everyone pays his share but more important everybody has some means of everything being pointed out to him, the cost of these services they are demanding. For this reason we wouldn't suggest an increase in the basic exemption of $1,000.00. I think our reasons for not suggesting some decrease are, perhaps, less valid.

MR. McMACKIN: Mr. Chairman, I think there was a further point that the administrative problems, if you reduced the exemption say to $800.00 or $750.00 or something like that, you would get a large number of taxpayers from whom in total a relatively small amount of tax would be assessed, the type of people who have a very high collection loss, and generally the administrative problems would be aggravated out of proportion to what we hope to raise, and also I think you are then at the level where today the individual -- this question of public awareness could hardly be

expected to reach down to the average individual who is only at that income level.

MR. COYNE: In other words the minimum basic exemption may be justifiable purely on administrative grounds quite apart from any other grounds.

MR. McMACKIN: I don't know that was the committee's view. I don't think we discussed it.

MR. LITTLE: I think it is a fair question. Mr. Lachance, this basically is his chapter, may wish to comment. Would you like to add anything to that?

MR. LACHANCE: Not really because it is pretty well covered. I can't think of any really good reasons for increasing or decreasing and I think my fellow committee members stated the position very well.

MR. COYNE: Well now, passing on to other aspects of this chapter, this chapter perhaps differs from the ones we were considering heretofore, because it is a series of rather more detailed recommendations. I am not proposing to deal with them all at all simply because in most cases they are perfectly clear and there is no need to elicit any further understanding. However I think we have to refer to a few of them.

In the first subsection Reporting in Income you comment on the gap of reporting of income which results from the Departmental practice of not requiring T-5 returns on amounts less than $100.00 and you suggest three possible solutions, one of which would be the imposition of a withholding tax of 15 per cent on all interest and dividend payments. Of course, I realize in a sense this is, perhaps, part of your overall proposal

with regard to dividends. The question has been suggested to me, and you might comment briefly as to whether you would anticipate any significant administrative difficulties or added costs in the imposition of an overall withholding tax on interest and dividends from either the point of view of the tax department or the taxpayer.

MR. LACHANCE: Mr. Chairman, this withholding tax on interest was sort of slipped in here. It would be a method of collection rather than a tax per se, and I am afraid it couldn't be done without increasing somebody else's costs including the administration. We haven't any idea how much. We thought that the research staff of the Commission perhaps had a better means of discovering whether this was a practical recommendation or not.

MR. COYNE: Incidentally this is really not relating to the withholding tax proposal you have on corporate distribution, it is merely a collection device you have here.

MR. LACHANCE: That is right.

MR. COYNE: If we might turn to page 48 under heading Benefits to Employees you point out certain anomalies which arise out of the special calculations to be made under sections 36 and 85A, in particular where calculations have to be made in both sections in respect of the same year or a portion of the year. You recommend that amendments be made to the appropriate sections of the Act to correct these anomalies. My question is simply this: Are you able to make or have you given consideration to any specific suggestion as to

the method by which these anomalies could be removed because afterall very different results would follow depending upon the particular solution which might be adopted. For example should the two Sections be made mutually exclusive or should the calculations provided for be only taken into account in respect of the provisions of those two sections and not other sections of Part I.

MR. LACHANCE: I don't believe, Mr. Chairman, that the committee as a whole worked out any recommendations on that, or detailed recommendations, but I made a few notes myself and I would think that in Section 85a, computing the income which receives section 36 treatment should be regarded as income. It is not now.

Any Section 36 treatment on stock options, benefits and tax thereon under Section 85A should be excluded from the averaging years because you have the high income amount and low tax amount. I think that Section 85A benefits on the tax should be excluded for purposes of charitable donation limitations and for gift tax exemptions.

MR. COYNE: I suppose, Mr. Chairman, that these are in a measure matters of detail which the staff will be looking at and they might well at some stage seek further assistance on the appropriate cases from the committee or some of its members.

MR. LITTLE: We would be glad, Mr. Chairman, if we could be of direct assistance in making suggestions on these things. We simply didn't put them forward because it seemed relatively simply. It is perfectly clear what

the net results are. It is a question of tidying up a few Sections with a few words. We assumed it was so simple we just left it.

MR. COYNE: They are very useful suggestions, but sometimes the staff don't find them so simple when they are endeavouring to work out positive steps that might, in fact, be taken. On page 49 in dealing with expenses of salaried employees you recommend in fact that such employees should be permitted to deduct all outlays or expenses made or incurred exclusively for the purpose of earning income and necessary for the performance of their duties. I wonder if I might ask this: Is it the broad intent of this recommendation to put salaried employees in exactly the same position or as nearly as may be to the position of persons deriving business from a business as far as the deduction of expenses is concerned?

MR. LACHANCE: I believe, Mr. Coyne, this would be a step in that direction. I don't think we intended to go all that far. We had in mind when we made this recommendation some tax cases that we think resulted in inequities. There were a series of cases where professional entertainers were denied deduction for expenses because it was held that their contracts were for employment rather than to render business services and it was often pretty hard to really distinguish these people. There was a couple of cases of electricians where they were required to supply tools to do the work or a mechanic and there was no means of deduction in any way in connection with these tools.

The salaried manager of a drugstore who delivered goods with his own car wasn't able to get any deduction. This is the sort of thing we had in mind. It may be it has been drawn a little broadly.

MR. COYNE: That was actually the purpose of my questioning. You have spoken of certain specific examples which have arisen in the Courts under which deductions have been denied because of the limited nature of the present Section, but on the other hand your recommendation is couched in what I might call broad language which would seem to cover certainlymany more occupations than the ones you have just spoken of in relation to the problems which have arisen. I was interested in knowing whether you were, in fact, putting forward a quite general proposition as to how expenses actually incurred by salaried employees should be dealt with. Heretofore they have usually not been allowed as deductions subject to the specific groups being dealt with in certain subsections of Section 11.

MR. LITTLE: I think we weren't trying to broaden it in that sense. We we would recognize in respect of salaried persons as a group that we rely on the employer to do the proper thing in the scale of recompense to cover all the incidentals that might have to be borne. It is these individual cases such as Mr. Lachance mentioned where individual people -- the odd case that has been a hardship to them.

MR. COYNE: Perhaps it is only in exceptional cases that, probably, employees have to bear expenses?

MR. LITTLE: Yes.

MR. McMACKIN: I think the practical difficulty of that, as Mr. Little says -- the practical difficulty is to take care of these exemptions because no matter what you do you will always have some some exemptions. The difficulty is to take all the exemptions in by a general provision alone like in the United States and in Great Britain where subject to certain restrictions employment is a business. That is not our Committee's recommendation. The difficulty is drawing a line between that and merely broadening the present restrictions.

MR. COYNE: Your recommendation is of a general nature.

MR. McMACKIN: It is.

MR. COYNE: You only have in mind specific instances where it would be of that nature as of this moment.

MR. LITTLE: We wouldn't wish to put it forward in a way that would suggest a salaried person should be able to deduct car fare getting to the office while it is certainly a necessary expenditure in the performance of his duties and there is no question about it. This wasn't our intent.

MR. COYNE: Perhaps that would be a personal living expense. A rather small point, at the bottom of page 50, and this is dealing with the fact that certain fringe benefits are not included in the income of an employee under Section 5(1)(a), but on the other hand are not deductible at the moment in the case of a self-employed person or one whose employer doesn't provide

these benefits. You recommend the individual who is self-employed or whose employer does not provide group life, sickness and accident insurance or medical service plans be entitled to deduct 50 per cent of the premium of comparable coverage up to an amount of $100.00 per annum and, further, that the deduction of such amount not alter the deductibility of the actual medical expenses. I am curious as to what led you to arrive at the figures you suggest there such as the 50 per cent and the $100.00, particularly the 50 per cent.

MR. LACHANCE: Well, Mr. Chairman, it was really the principle we were interested in putting forward and the $100.00 amount is purely an arbitrary figure that we picked out of the air. The 50 per cent did derive from the fact that we think it is fairly common that employor pays 50 per cent of the cost of employee plans and that the employee pays his share so this was the way we worked it out for the employed man who is insuring himself. That is why we gave that percentage.

MR. COYNE: Sort of rough justice?

MR. LACHANCE: That is the idea.

MR. COYNE: One point in connection with your comment on the pension plans, your principle suggestion is that some rules be formulated and issued and that there be a policing of the operation of pension plans to see that the rules are acceded to. On page 52 however you deal with a point which puzzles me somewhat, particularly the section where you suggest that Section 12 be amended by introducing a provision to limit the deduction for pension contributions to the amounts

permitted by Section 11. This may really be a legal question and perhaps you don't want to deal with it too extensively, but I would put it to you in this way: Since deductions listed in Section 11 which include pension plan contributions as specifically allowed under Section 11, notwithstanding paragraph a, b and h of subsection 1 of section 12, why do you feel an amendment to Section 12 is necessary for this purpose?

MR. LACHANCE: I thought we had explained this in the first part of this paragraph where we say Section 11 purports to permit the deduction of pension contributions, we should interpolate there, by an employer, within certain limits. We think that now any employer could properly provide a pension plan for his employees and be entitled to a deduction for his contribution whether or not that plan was registered. We think this is possible. The effect of section 11(1)(g) is really just a permissive one and not necessarily a restrictive one. We would therefore feel that if we restrict the deduction of contributions by employers to pension plans that we should put it under section 12.

MR. COYNE: In other words you take the view that under the general provisions of this Act, you suggest in section 12 employers might be able to claim deductions of contributions to pension plans other than registered plans which are provided for now under Section 11.

MR. LACHANCE: That is right.

MR. COYNE: And it is to restrict the allowability of contributions to registered plans that you suggest

this amendment?

MR. LACHANCE: Yes.

MR. TOWNSEND: Yes, our position is we feel that presently because of the changing nature of pensions over the past century it is not now a capital item and therefore contributions for registered plans and unregistered plans could both be made without any limitation under Section 12.

MR. COYNE: 12(2)?

MR. TOWNSEND: Right. I have never heard of anybody attempting to use this item or being successful, but this is something we think is a technical flaw in the drawing.

MR. COYNE: The possibility, you feel, is more likely to be a factor today than it was years ago when other views were taken of the nature of pension contributions?

MR. TOWNSEND: That is right.

MR. COYNE: Well then, towards the bottom of page 52 you are dealing with profit sharing plans and you point out certain problems and confusion as between the two sections, 79 and 79C and suggest that the Commission should attempt to determine the policy underlying these provisions and recommend appropriate implementing legislation. Perhaps, unfortunately the task of the Commission is not so much as to fathom what the policy underlying existing provisions are, but rather to determine and recommend what the policies for the future should be. My question is does the committee have any recommendations as to what the tax policy should be in respect of profit

sharing plans.

MR. LACHANCE: I think, Mr. Coyne, if we had any such an opinion we would have said so. I couldn't for the life of me decide for my own account just why these different profit sharing schemes were introduced into the Act.

MR. COYNE: Do you feel it is necessary?

MR. LACHANCE: I think this was restrictive, being tied to the pension provision, but it is just a sort of poor man's type of pension plan. It isn't anything additional that is being offered by way of incentive to profit sharing plans. For one thing it doesn't give the employees any opportunity to contribute or participate in future pensions to be kept out of such a plan, although it is tied to the pension plan restrictions.

MR. COYNE: What do you refer to as pension plan restrictions?

MR. LACHANCE: $1500.00 per person. There is a limitation that the employer cannot contribute more than $1500.00 per employee per year. If there is a registered pension plan also in existence then the total contribution from the two plans per employee is $1500.00. This is tied right in.

MR. COYNE: Your criticism of course, and I think it is clear in the brief, is that the ability to contribute to these plans is too restricted, and indeed is much more restricted when one takes into account the possibility of employee contributions within other types of pension plans.

MR. LACHANCE : One first thinks of a profit sharing plan as offering some sort of incentive to employees to work harder or earn more money for themselves and for their employer, and it seems to me the way this one is designed you just can't do that.

MR. LITTLE: I think another feature about this, Mr. Coyne, perhaps the one thing that would make a deferred profit sharing plan attractive, once again, is the personal income tax feature. Certainly the profit sharing plan as such has proven to be a tremendously effective incentive in many industries. The deferred profit sharing plan is simply a way of setting aside so the individual has no taxes but is taxed at some later time. If we made substantial changes in our tax structure and lessened the impact on the individual then this sort of thing would become less necessary. The fact of the matter now is as Mr. Lachance said it doesn't make sense, this deferred, this whole procedure. If you have a pension already in existence you may not be able to which seems rather ridiculous.

MR. COYNE: Thank you. I appreciate your point. Has the committee given any thought or consideration to a level of contribution that might properly be permitted in plans of this nature as against the very limited possibilities that now exist?

MR. LACHANCE: We did suggest that it might, the share plan contribution by the employer might be related to the total payroll of the employees participating in the plan, and in this regard we would imagine a percentage of 5 per cent of the earnings, limited to 5

or 10 per cent of profits with some limitation on it. This is the way these schemes are usually put together in the United States which is where most of these have been devised. Doing it that way I think the plan would provide more flexibility; divide up the company's contribution on the basis of the employees annual earnings and seniority or using some other rules. A person might receive, maybe $3,000.00 out of the plan where somebody in the same income bracket but who had only started to work last year may only get $1,000.00. This artificial limitation of $1500.00 just cuts the purpose of the plan to pieces.

MR. COYNE: Do you take the view of subsection 7 that the amount that can be contributed in the plan to any individual employee is limited to $1500.00 or that the total amount of the contribution may not be more than an aggregate of $1500.00 per man? In other words you could allocate $2500.00 or $3,000.00 to a particular employee if that was the nature of the scheme.

MR. LACHANCE: I don't think you can tie that in with B where you have to take into account what has been contributed under the pension plan.

MR. COYNE: I agree, Mr. Lachance. I think it is a very unclear and very poor law at the moment. There are two possible interpretations of it, but one of them is certainly not the one you approve of.

MR. LITTLE: I think the latter one as you say, where there isn't a registered pension plan, then it is $1500.00 times the number of employees.

MR. COYNE: You would agree it is not very

clear drafting.

Turning now to the question of stock options which you deal with on page 63 you recommend that the 20 per cent tax credit be withdrawn and also the introduction of two restrictions mainly that the option price should be at least 95 per cent of the value of the stock when the option is granted and that the option must be exercised during employment or within six months of termination. Now, I understand that the United States has restrictions rather similar to this except I think their value requirement is only 85 per cent and I think that the option must be exercised during employment or within six months thereafter. In addition I understand that in the United States there are two additional restrictions, one is to limit the term of the option basically to a period of ten years and further that the option must not be transferred except by inheritance. Would the Committee have any comment on the advantages or disadvantages of adopting provisions in this country limiting the term of option and its transferability as far as tax results are concerned?

MR. SIMONTON: Mr. Coyne in one of our earlier drafts of this section we had in it a limitation on the terms, but after further discussion in our committee we couldn't see the need or the reason for having a maximum term on it, stock options, so we took out that restriction which was in, as I say, the earlier draft. I don't think we had other restrictions in.

MR. COYNE: I suppose, Mr. Simonton, it is not a restriction, it is permission that the option may

be transferable by inheritance and still survive the succession, which I believe would carry with it at the present time certain tax that to the employee or to the employee's estate would it not?

MR. LITTLE: I think that is correct. The provisions really wouldn't apply, as I understand it to anyone except the employee.

MR. COYNE: Yes, and if I am correct in the United States they do permit the transfer of these options under favourable conditions.

MR.SIMONTON: Yes, you are correct.

MR. COYNE: Would you have any view on that matter, as to its desirability or undesirability?

MR. LITTLE: I think that would be perfectly reasonable and desirable. Afterall the purpose of the stock otpion award is an incentive that becomes a part of a man's assets at the time he exercises it. It is a benefit that is there for him. It would seem unfair that the mere fact of his untimely death should prohibit his exercising it when if he had done it the day before it would be part of his estate. I think we would all agree it is a perfectly reasonable proposal.

MR. TOWNSEND: If such a provision is put into the Statute does that mean for the last three years the employee's income will be measured accordingly if the stock option has gone into the estate and is taken out by his widow?

MR. COYNE: I suppose there might be a number of alternative choices. That would obviously be a problem that would have to be dealt with in any

legislation.

MR. TOWNSEND: My own feeling would be, while I would agree that the transfer should be allowed, but I would think that the tax should be separate and not transferred with it.

MR. LITTLE: It would probably be taxed as though he had exercised it.

MR. COYNE: I suppose it might also be logical or justifiable to regard his death as termination of employment and require the option be exercised within the following six months.

MR. LITTLE: It would be an alternative.

COMMISSIONER GRANT: Just two points: If that were transferred to the estate and if the employee were unmarried and died without leaving a will it would then be exercised under the provisions of the Descent of Property Act or whatever Act was in force in the province governing the estate of the deceased. It could be that the brothers or sisters or father and mother would become shareholders in that corporation by exercising it and not the widow, not the man's children. I can see the company's obligation to that man's widow and to his family, but I don't think that the company has any obligation to the man's father, mother, sister, brother or the widow of the deceased's brother.

MR. COYNE: Or otherwise it might be transferred to any certain class of inheritors is what you are suggesting.

MR. LITTLE: Might I make one gratitutious comment. There are two schools of thought about the

20 per cent credit that applies in this calculation. My understanding is that it was introduced into the organization, I think it was under discussion in House, I believe because of the facts that this is a case of the granting company making sale of shares at lower prices than it could have in the marketplace. This is a cost to them for which they get no deduction, therefore it is in a sense the same as though it was distributed surplus without tax and if it were a dividend this 20 per cent would apply. There are people who suggest the corporation ought to be entitled to a deduction for all tax option benefits. We dismissed this as something we felt was unnecessary, or, perhaps, even practical.

THE CHAIRMAN: Mr. Little, wouldn't have to meet the accounting tests before we put it to taxation, and accounting certainly to the best of my knowledge hasn't resolved that difficulty.

MR. LITTLE: That I can tell you.

MR. COYNE: Just on a related subject, Mr. Little, is there not a second school of thought as far as the 95 per cent limitation is concerned. As I understand it when the legislation was originally proposed it contained a provision for a 95 % limitation and then it was, the Minister of Finance of the day removed it for a number of reasons.

MR. LITTLE: I don't know if we would have any strong views between 85 and 95. This is an area of opinion. We think some reasonable limitation is necessary, is desirable because the theory of the stock option, presumably, is an incentive award for future

performance, and in the executive group, if you don't have any such limitation they would give the executive a share for $1.00 that is obviously worth $100.00 on the marketplace. We could see no justification for extending it in that way. That is why we have this limitation of some reasonable valuation.

MR. COYNE: Even in the basic theory there is no justification for special treatment of stock options?

MR. LITTLE: It depends what the basic theory ought to be.

THE CHAIRMAN: It depends on the view of what a stock option ought to be. I am going to come to that matter. I don't want to interrupt you now.

MR. COYNE: I was going to pass on.

THE CHAIRMAN: That is all right, go ahead.

MR. COYNE: One quite different subject, and a small point on page 55: You recommend that premiums paid to provincially operated hospital and medical schemes be allowed as medical expenses. My question is, would it not be logical accepting your recommendation, to treat private schemes in the same way, that is allow the premiums paid to private schemes, but not payments actually made by the plans on the taxpayer's behalf as they are not actually out-of-pocket expenses to him.

MR. LITTLE: I am not sure that we have a considered view on this, but certainly I would agree with that.

MR. LACHANCE: That is to allow deductions of all such premiums?

MR. COYNE: It would be regarded as medical

expenses as I understood your suggestion.

MR. LACHANCE: You are changing the suggestion. You are throwing all programs into one pot. They are not more than 3 per cent. We will give him the deduction because that always will be ---

MR. COYNE: I am not making myself clear. As I understand it at the present time the premiums to the provincially operated schemes are not a medical expense nor are the payments made by those schemes on the taxpayer's behalf. On the other hand so far as the private schemes are concerned in insurance principles the premiums are not a medical expense but the payments made by the plans on the taxpayer's behalf are medical expenses to him even though they are not out-of-pocket expenses.

MR. LACHANCE: That is correct.

MR. COYNE: I am suggesting that accepting your proposal that the premiums paid to the government schemes should be treated as medical expenses, would it not be logical to switch around the terms of private plans, allow premiums to these plans as medical expenses but not payments made by the plans to the hospitals, to the doctors, etc. which are not out-of-pocket expenses to the taxpayer.

MR. LACHANCE: That is the way I understood you the first time. If you take your total premiums they might not amount to more than $150.00. Unless you removed this 3 per cent floor on medical expense deductions you would never get medical expenses in excess of 3 per cent of your income. This move would be

one to deny a person all medical expenses.

THE CHAIRMAN: Isn't that fair enough?

MR. COYNE: He didn't make the medical payments?

MR. LACHANCE: He paid the premiums.

MR. COYNE: Supposing that a man pays a $30.00 premium and then due to a misfortune the plan spends $3,000.00 on his behalf. He hasn't spent $3,000.00, but under the present scheme he is entitled to regard that as medical expenses and claim such deductions as he is entitled to. If one is to allow premiums paid to the government schemes as medical expenses wouldn't it be logical to treat private plans the same way and regard the premiums as medical expenses, being an out-of-pocket expense to the taxpayer and not the $3,000.00 which never came out of the taxpayer's pocket anyway.

MR. LACHANCE: I would agree with you, if you take away this floor and you pay $150.00 in premiums and you can deduct it from your taxable income.

MR. COYNE: Why is that relevant to the proposition I am putting to you?

MR. GORDON: With the deduction of the premium, if you don't take away the 3 per cent it would exclude the premium.

COMMISSIONER PERRY: That is the point.

MR. LITTLE: I must say I think the point is a very good one. It is a relieving provision. It is one designed to prevent real hardship to the person who suffers large medical expenses.

MR. COYNE: Out of his own pocket.

MR. LITTLE: If this is the philosophy, the relieving provision will then -- we have to admit the logic of your statement, he should deduct only what he pays. Medical expenses per se ought to be considered as deductible items if this was so.

THE CHAIRMAN: Mr. Little, I can certainly testify there is something the matter with the law as it stands now. My last illness was quite profitable to me, and that is not the purpose of our tax laws.

MR. COYNE: I suppose this is speculation. There might be administrative difficulties in trying to trace premiums.

THE CHAIRMAN: It has now reached the hour when I said we would cease, in fact it has gone beyond it. I think we might as well hold this over to tomorrow. I think the attention up here will be improved and we will have lots of time. You probably have half an hour or more on this chapter?

MR. COYNE: Not quite.

THE CHAIRMAN: I suspect the questions from up here will be fifteen minutes to half an hour. It is a pretty important sector. From there on I think we will move a little faster. We will stand over until 9:30 tomorrow morning.

---Whereupon the hearing adjourned at 5:40 o'clock p.m. to 9:30 o'clock a.m., Friday, December 13th, 1963.

ROYAL COMMISSION

ON

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HEARINGS

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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Friday, the 13th day of December, 1963.

C O M M I S S I O N

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RESEARCH DIRECTOR

PROF. D. G. HARTLE

SECRETARY

MR. G. L. BENNETT

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Ottawa, Ontario,
Friday,
December 13, 1963.

---On resuming at 9:30 o'clock a.m.

THE CHAIRMAN: We are ready now to start. Mr. Secretary, have you anything to say?

THE SECRETARY: Not at this time.

THE CHAIRMAN: Are you ready, Mr. Little?

MR. LITTLE: Yes.

THE CHAIRMAN: Are you ready, Mr. Coyne?

MR. COYNE: Yes. Thank you, Mr. Chairman. Mr. Little, I wonder if we could turn to page 55 which is where we were when we broke off last night.

In paragraph 158, in the middle of that page, you make two recommendations with regard to expenditures on scientific research. The first is that any person with taxable income in Canada should be entitled to deduct such expenditures, and not only taxpayers who carry on business in Canada. Secondly, you recommend that except for purposes of Section 72a, expenditures made outside as well as inside Canada should be deductible.

I put it to you that this second recommendation in particular raises the question as to whether the purposes of these sections should be to encourage Canadians to spend money on scientific research, or to encourage the development of scientific research in Canada.

I wonder if you would comment on which of these purposes you regard as the proper one.

MR. LITTLE: I think that fundamentally the

feeling is that research expenditure per se is desirable and it ought not to be discouraged, even though it may not take place in Canada. A secondary aim or object of the legislation is to have it done inside this country. I think our main point is the research should be carried on.

MR. COYNE: Proposing a more specific question, would not the effect of your second recommendation be to encourage Canadians to spend their research money abroad and should we encourage Canadians to carry on scientific research abroad?

MR. LITTLE: I do not think we would assume that is the end result. It would encourage Canadians to spend their research money in the most suitable place, which might be in Canada or might be abroad.

MR. COYNE: In other words, as far as your committee is concerned, the important feature of these sections is the encouragement of expenditures on research and any encouragement of the development of scientific research within Canada would be secondary?

MR. LITTLE: That is right.

MR. COYNE: I wonder, since it deals with the same subject, if we could turn to page 63, paragraph 183. This appears under Chapter X, which is headed "Incentives".

I am a little puzzled by the recommendation which you made here in connection with Section 172a.

First, if I could go back to the bottom of page 62, you make a general comment. You say:

"In most cases, in the opinion of the committee, these incentives have

been ineffective and have in some cases, in fact, resulted in windfalls to the taxpayers, received for something they would have done in any event."

Then, at the bottom of page 63, you say:

"One recent incentive which seems to have avoided the faults referred to above and which appears, initially, at least, to be effective is the deduction from corporate income of 150 per cent of the amount spent on increased research expenditures in Canada."

Then you comment unfavourably on the use of the base period and recommend that all scientific research expenditures be eligible for the additional allowance, without reference to any base.

I put it to you as to whether or not that recommendation is inconsistent with the view that you appear to take of incentives generally, that they should be used to persuade people to do something they would not have done and not be given to people who would have done what was desired in any event.

MR. LITTLE: I do not think we would accept that proposition. I think that when we make the statement on page 62, I think there has been very much in our minds the unfortunate sales incentive legislation that was introduced and withdrawn in the last budget. This was a situation which, in our view, produced most

unusual results and did in fact result in windfall gains to certain taxpayers.

So far as the research incentive is concerned, we think it is a good one because it is substantial and in this respect differs from many of the incentive pieces of legislation that we have had.

So far as equity and reasonableness is concerned, as between taxpayers, it does not seem right to us that the company which has striven to do its part in Canada and has in fact put up its research laboratories and so on in this country, that it should be treated any differently than the person who is now persuaded to come into this country with research expenditures, as we see in this piece of legislation. I can see what you are driving at, that the person who is now doing research in Canada has to do it anyway and is doing it and therefore how do we reconcile this with our suggestion that incentive is not right if it benefits people who would have done it anyway.

I can see that inconsistency, but I think that in the best interests of fairness and equity, if we are to deal with research expenditures in such a fashion, it could apply to all expenditures.

MR. COYNE: Would you not draw a distinction between the treatment of research expenditures under Section 72, which permits the deductibility of all research expenditures, to every one, and the provisions under Section 72a which are admittedly an incentive measure. I think we more or less agreed yesterday that incentives are, by their very nature, discriminatory.

In other words, normal aspects of equity and fairness may not be equally applicable in the case of pure incentive legislation.

MR. LITTLE: That is true. They certainly are discriminatory as between one class of taxpayer and another and I think we are simply reaching for more fairness when we suggest it should be applicable to all research expenditure and that there is not any discrimination against any person who had been willing in the past to go and do research in Canada, as opposed to anything else.

MR. COYNE: If he spent $1 million in a year in the past, he is to be entitled to take that $1 million for tax purposes.

THE CHAIRMAN: In order to be clear on this I take it that you consider that, under Section 72, this should be irrespective of what country it was in and should not be restricted to Canada.

MR. LITTLE: Section 72a is restricted.

MR. COYNE: They would restrict it to Canada, but would remove the base, so that all the expenditures restricted to Canada would be entitled to 150 per cent.

THE CHAIRMAN: Yes.

MR. COYNE: I think your position is perfectly clear, Mr. Little, and perhaps we could go back to the previous chapter and look at page 56, where you deal with the question of "income averaging". In paragraph 160 you recommend:

"That the restrictions in regard to sources of income be

removed from Section 42 and that
in their place they be introduced
restrictions based on the taxpayer's
flow of income".

Of course, the restrictions under Section 42 at the moment limit those provisions to farmers and fishermen.

My question is, how would your recommendation to generalize these provisions affect farmers and fishermen? Are they still to be permitted to average their incomes, as now, or are they to be restricted in the manner you suggest for all taxpayers, in the next paragraph.

MR. LITTLE: We were not intending to change the position with respect to farmers and fishermen. If this is the result of our recommendation, we are in error. We intended to widen it.

MR. COYNE: In other words, you would leave farmers and fishermen as they are now, with permission to average the realization of income from year to year; and these provisions would apply to all other taxpayers?

MR. LITTLE: That is right.

MR. COYNE: My next question, arising from paragraph 161, is merely to ask you how you reach the conclusion that the excess of one year's income over another should be more than 100 per cent before averaging would be permitted. For example, I note that in the 1963 tax message, the President of the United States in dealing with this subject, recommended a 33-1/3 per cent figure in order to qualify for an added provision. Could you comment on that 100 per

cent figure?

MR. LITTLE: Yes. It is simply a way of ensuring that averaging only takes place in those situations where it is really needed. The 100 per cent figure is obviously another way of stating that someone's income is double what it was in the previous taxation period; and the averaging provision would apply.

I must say, Mr. Coyne, that we did not discuss the President's suggestion. I might also say we did not pay any particular attention at all to current discussion in the United States with respect to particular tax changes, except for the effect of overall rates of both corporate and personal tax, which we in this country cannot ignore.

So far as these particular provisions are concerned, we did not discuss them. Therefore, in making a reply to your question now, I am on this occasion speaking entirely for myself. It would seem to me that the 33-1/3 per cent provision is really an extension that is really not warranted or required. In the first place, the hardship that would result, in my view, would be very small. If you take the 33-1/3 per cent figure, it would mean that a person with an income of $12,000.00, who finds himself with $16,000.00, would be permitted to average; and I do not think that is necessary.

Furthermore, the problem of administration would be magnified very substantially, if this were so.

Under our provision, the person with $12,000.00 would not be permitted to average, unless it went up to

$24,000.00. This is a fluctuation which can result in extreme change in the burden of impact of tax, because of the rates.

There is no magic about 100 per cent, it is just that we are trying to arrive at a point where we believe hardship would result, and we do not think that real hardship results from a modest fluctuation, which may take place in a person's tax.

MR. COYNE: I understand. To put it another way, a provision which is admittedly restricted in your judgment would adequately meet the case of real hardship where some relief would be justified?

MR. LITTLE: Yes, indeed.

MR. COYNE: There have, of course, been suggestions from various sources, and it is a matter that is occasionally canvassed, that taxpayers should be permitted to average their income much more liberally, such as on a lifetime basis, or on a constantly shifting average. Did the committee give any consideration to a more extensive form of income averaging, such as I have spoken of?

MR. LITTLE: We did, in an oblique sort of way, in the discussions we had about 100 per cent provision in this. In the course of that process, we had a discussion as to whether or not more liberalization of the averaging privilege ought to be adopted and I think our feeling was "no", that until you have fluctuation of income of this magnitude one does not really suffer great hardship.

On the other hand we have always been mindful

of the administrative problem of assessing and controlling tax returns, if you widen the thing too far.

MR. COYNE: Therefore, we might go on to the section on "Husband and Wife", which commences on page 57. There is just one general question with regard to your recommendation in paragraph 163. May I say, there are two recommendations there.

I take it that the test of reasonableness which you suggest in these two recommendations is a test similar to those now in the Act, and is a question of reasonableness which would be one for the courts and not for the Minister of National Revenue.

MR. LITTLE: I do not think there is any indication in the present Act as to the word "reasonable", Mr. Coyne.

MR. COYNE: Not in this context, but in another context, there are certain things which can be done to the expenditure if they are reasonable, and the question as to whether they are reasonable, if in dispute, goes to the court.

MR. LITTLE: You are quite right. Reference is made to reasonableness. I think this is quite so. As a problem of administration, the Minister in the first instance would have to make up his own mind.

MR. COYNE: But this does not contemplate that he has discretionary power?

MR. LITTLE: No.

MR. COYNE: On page 58, paragraph 164, you criticize the operation of Section 21(1) and you recommend in effect that it should not apply in the case

of transfers by way of bona fide sale at fair market value. You state, in support of this recommendation, that the present section"disregards normal business transactions and is inconsistent with the original intention which was merely to restrict the transfer of income from property which was transferred for inadequate consideration."

I put this to you, that perhaps the original intention was not quite as you state, that is, merely to restrict transfers for inadequate consideration, but rather to prevent income splitting.

Further, I ask you whether your suggestion might not to some extent frustrate that purpose. I put this sort of illustration to you, where a man sells a piece of income producing property to his wife, by way of a bona fide sale at fair market value, taking back by way of consideration, let us say, securities of one kind or another, notes, mortgages -- and then at some later stage, as I conceive that he would be quite entitled to do, forgive the amount, or some part of the amount of the consideration which would otherwise be payable over a period.

Would not a situation of this kind indeed result in very effective income splitting, which it is the purpose of the section to prevent?

MR. LITTLE: Yes, that is a very clear comment. I think that I also should say that perhaps we had gone too far when we referred to the original intention of the legislation. This was our assumption as to what the original intention was.

MR. COYNE: I do not know that I know what the original intention is, but possibly there were several intentions.

MR. LITTLE: One would assume it was to prevent that very thing, of simply giving property of one sort or another to one's way and as a result hiveing off the income flow.

We could conceive many circumstances where, because of having an independent means or source of wealth, there are occasions when it is appropriate for a husband in fact to sell something to a wife and where, keeping it in simple terms, because of the wording of the Act such a bona fide transaction as that would be trapped by the word "transferred" in the section. This we think is unfortunate and should be avoided.

We have certainly no intention of re-opening a problem, by making it possible to sell something to a wife in exchange for a note which would then be forgiven, because this would simply be defeating the process which would have followed had he given by way of gift an income producing property, because if he had done so the income would be taxed in his name under the particular provisions of the Act.

If we had opened up a loophole as a result of this, then we should bitch.

MR. COYNE: This may be essentially a drafting problem, and there is no need for us to get into that aspect of it.

Would it be fair to say that the committee in this context would look towards some type of provision

which would relieve the problem that you put forward but would not encourage or permit income splitting, which appears to be inconsistent with the purposes of the Act?

MR. LITTLE: Absolutely.

MR. McMACKIN: I wonder if I could add a word. I think, in your example, Mr. Coyne, where you referred to the eventual forgiveness of the debt, each forgiveness would constitute a gift.

MR. COYNE: Quite.

MR. McMACKIN: And it would not be very hard, even under the present law, iw ould not be very hard to make a provision whereupon, as to such gift, the income reasonably attributable to that gift would again become income of the husband.

MR. COYNE: That would be quite possible. Of course there are other examples. I could just mention one. Properties have different income, irrespective of their values, and you could exchange properties, one of which carried more income than the other; and it would be a perfectly bona fide transfer for full consideration, but the result would be more income transferred to the wife than came back to the husband.

MR. McMACKIN: The classic example would be unproductive land at speculative value.

MR. LITTLE: Mr. Coyne, surely one should not attempt to stop an exchange where there is in fact full value on each side, in the example you suggest. Surely, if the value is there, both husband and wife could go into the market place and sell the property and

with the resulting cash inflow they could reinvest; and the wife could pick up the property and the husband forgo it. Surely one should not stop that.

MR. COYNE: Yes. Where there certainly has been a transfer between husband and wife.

We are talking here only in the context of transfer from one spouse to another.

MR. GARNEAU: At this point, it might be the right to time to interject the Quebec problem. If these sections are to be considered, possibly the Commissioners would have to provide in an unusual manner for the Province of Quebec, where no gift or sale is allowed to take place between consorts. At present, the law as it is now more or less brings the whole of Canada in line with the Province of Quebec.

We would be departing from that if we introduced anything which probably would have the result of constructive sales or gift or something of that sort, as regards the Province of Quebec.

MR. COYNE: I see your point, Mr. Garneau. If some such provision was adopted, it might militate against people in the Province of Quebec, because of the law that there cannot be gifts of property or sales between consorts.

MR. GARNEAU: Unless the assessors handle this like they do the "community of property" problems. From what I understand, they simply disregard them as if they did not exist. If a woman brings to the community a large income, the income, according to "community of property" rules, would be taxable in the man's hands and

added to his earnings, otherwise. I understand they disregarded that completely and will tax the income of that property in the hands of the wife.

MR. COYNE: Under the general provisions of the Income Tax Act, rather than taking account of the legal provision in the province.

MR. GARNEAU: I do not think we should be unhappy about that situation. It is hardly the ruling of law that we are striving for.

THE CHAIRMAN: That has not been tested in the courts.

MR. GARNEAU: I do not think it has.

THE CHAIRMAN: There was one issue on community which was in the courts.

MR. GARNEAU: It was a matter of husband and wife to split salary between the man and his wife. That was refused and as far as I am concerned it was properly refused; but the other apparently goes on and it is an administrative manner in doing it.

MR. COYNE: Normally this aspect, Mr. Garneau, would work to the advantage of the taxpayer, unless the wife happened to have by far the largest portion of the income and therefore unlikely to be challenged in the courts.

MR. GARNEAU: Oh yes it would not be challenged.

MR. COYNE: Certain provisions of the code with regard to personal property between husband and wife are relevant to any consideration of this question we have been discussing.

MR. GARNEAU: Yes, there are a few other chapters of the Civil Code which bear on gift taxes.

MR. COYNE: Quite so.

I have completed my questions on chapter 7.

THE CHAIRMAN: We have all some questions here on chapter 7. At what page did it start?

MR. COYNE: Page 45.

THE CHAIRMAN: You made reference generally to people leaving the country because of the high rates of personal taxes. If you were thinking of persons with jobs, scientists or engineers, and you indicated that because of taxation they were leaving the country, I would be curious to know where they would go. Where is there a country which can use this kind of people and charge them less tax.

MR. LITTLE: I am thinking of people retiring to the West Indies.

THE CHAIRMAN: I did not think you were talking about retired people. I am speaking of people who are earning their living here, such as scientists and engineers. Is that not what you are referring to, or are you only referring to retired people?

MR. LITTLE: We were not referring to retired people there; but I think you are quite right. There are two kinds of people we had in mind. There are those who would go elsewhere to pursue their own income, such as in the employ of somewhere else. In that case I really assumed we were thinking of the United States. We were thinking of wealthy people who can move away from Canada and conduct their business affairs from some

other source such as Bermuda, Nassau the Barbadoes and so on.

THE CHAIRMAN: Are we losing anything by those people departing from the country other than the tax on their succession? If they are conducting their affairs elsewhere they are presumably having regard to Canada in the conduct of their affairs?

MR. LITTLE: If they are, we simply lose three things. We lose the gift tax which is paid when they make transfers to their families; we lose eventually the estate tax when they die, as I suppose they must; and we lose income tax year by year, if they move off and devote their talents to developing interest in Canada, then there is that aspect of activities in which we would not lose.

THE CHAIRMAN: Mind you, loss of taxation has to be weighed against reduction of taxation necessary to keep them here. The reduction of taxation burden not only would fall on them but would fall on everybody.

MR. LITTLE: That is right.

THE CHAIRMAN: I do not know whether we would have a profit or a loss on such a balance, but I suspect there would be a lot taken away from the country before we would gain a profit.

MR. LITTLE: I think that is a very fair conclusion.

THE CHAIRMAN: You are not concerned about activities of people who are living on around the general income level in Canada. That is not what you are speaking about?

MR. LITTLE: I think there are two classes and we are concerned about them.

THE CHAIRMAN: Where do they go?

MR. LITTLE: To the United States.

THE CHAIRMAN: Yes? Are they taxed less?

MR. LITTLE: No. More.

THE CHAIRMAN: Then it is going to add to taxation.

MR. LITTLE: That is not the way they look at it.

THE CHAIRMAN: I am sorry I thought we were discussing taxation. Go ahead.

MR. LITTLE: I accept that. I think I stated yesterday that when we discussed this matter, the person who leaves Canada looks on his amount of pay and he is inclined to blame taxation for the fact that he has fewer dollars to spend than he would have in some other situation. The fact that he would have exactly the same effective rate of taxation in the United States, as he might as well do, escapes him, because he makes more salary to start with there, but in compared with the net dollars in the package at the end of the week he has more elsewhere. My suggestion was that he blames the tax situation.

THE CHAIRMAN: Surely every Canadian recognizes right away that he probably earns about 30 per cent less because he is working in Canada than he would if he were working in the United States. Generally we think of that as being a discount on our earnings. We are not proposing that the taxes be geared so as to recompense

Canadians for the loss of 30 per cent so that they will not go away.

MR. LITTLE: No.

THE CHAIRMAN: I would not think so, but you are saying it should be no less favourable a tax system or no worse, than it is in the United States?

MR. LITTLE: Yes.

THE CHAIRMAN: Thank you. Talking about high rates of taxation on persons, you thought that they should not be lower than 60 or 65 per cent and in that statement you were having regard to the marginal rate of tax?

MR. LITTLE: Yes.

THE CHAIRMAN: Now, if you are saying that, it would be equivalent to saying that anybody should be entitled to retain 35 or 40 per cent of his marginal earnings. The other day I noticed that somebody else in a different place said that one should be able to retain at least 50 per cent of his earnings. I think he was not thinking about the margin when he was saying that. I believe he was thinking about his total pay. We can now retain about 50 per cent of our earnings, up to about $100,000.00, I think it is. It is in that order. It might be $90,000.00 or $110,000.00, but it is in that order. Do you think there is any position one should have regard to as to the level of total taxation of an individual rather than marginal taxation of an individual? There is a law in one country which says that at no time shall any one part with more than half his income in taxes. Some European country passed laws saying that the top taxation shall be 50 per cent.

If that were the law in Canada we would have to bring down our top rates. Under that proposal of 60 or 65 per cent, I would think the 50 per cent total pay would occur at a pretty high figure. I am asking you really, should we have regard to the percentage?

MR. LITTLE: This was not something that we felt was sufficiently important to recommend, Mr. Chairman. There is also some logic in it but I do not think we are at all disturbed at having a rate structure that would get up to the point where, if income is large enough, the effective rate would be in excess of 50 per cent.

THE CHAIRMAN: No. I was struck by that statement the other day, as you probably were to, and I wondered if there was more to it than I saw.

MR. LITTLE: In that connection, you almost reach that situation, that $60,000.00, where tax on $60,000.00 of a taxpayer's income is $27,000.00, which roughly figuring is owfully close to $30,000.00. It is at that point that you begin to take half.

THE CHAIRMAN: As I see it, you can earn up to $100,000.00 before you take half the income.

The tax of $60,000.00 is the majority of the income, but the tax on $60,000.00 is $27,160.00.

MR. LITTLE: The tax on $100,000.00 is $60,295.00.

The table does not break at that point, but the tax on $90,000.00 is $45,000.00.

THE CHAIRMAN: I suppose what I am stressing is where he gets over 50 per cent and you are looking at where it first hits them. Now, as to split income, in

general terms, I observe that you do not rule it out. You say that it may be the thing to do. You come with a proposal that, as it would require a new set of rates, and as it would tax the bachelor pretty heavily, you think we might stay with what we have got. Is that a fair summary?

MR. LITTLE: I think so.

THE CHAIRMAN: I am impressed by the difference between two streams of income into a family and one stream of income into a family. I suppose I am impressed by that, seeing that Canada is one of the very few, but not the only one, that taxes the income in having imposed splitting the income or aggregating the income. There are other such countries -- the United States of America, Germany, France. These split the income.

Most other countries add the incomes together.

I made a few calculations to see what the difference would be between two equal streams of income as opposed to one stream of income, in the case of a family. At $6,000.00 income of the family, I find that if one spouse earned it, the tax would be $681.00, whereas if it were divided by the two of them, the tax would be $603.00. The difference there is $78.00. That is not a great lot. It represents 11 per cent of the tax, or $78.00. It would be a little over 1 per cent of the income, but still it is only $78.00.

At an income earnings of $12,000.00 it gets up to $2,230.00, as opposed to $1818.00 or 18½ per cent of the tax, or the family would be able to keep $400.00

more at the home, or it would be about 3 per cent of the income.

When it gets to $18,000.00, it amounts to $4,565.00, divided it would be $3,294.00; that would be an improvement of about $1,200.00, and $1,200.00 on $1,800.00 is quite a significant amount for a family spending.

When you go to the $24,000.00 income earned by one spouse, the tax is $7,200.00, as against $5,200.00, or 2,000 out of every 24,000 people. Again, I think it is a significant difference, where income comes in by one source or two sources.

I think those families would spend on their necessities the same amount of money where the two sources of income are only one. The tax should be about the same because the family is equal and so is the need.

I put this to you,wondering if I am stressing it too strongly, because if I am correct I would have thought that this is a very important matter, that would check the position between these two. What is your comment?

MR. LITTLE: I think Mr. Chairman we really came to the opposite conclusion, that they were directing our attention to the taxable income, then what marriage has to do with this is surely incidental. If we are approaching the taxation concept and looking to a stream of income, the fact that two people are married or single to us has no bearing. If we look at it in a family concept then you are quite right, other

considerations of course must come in as well. Presumably we should carefully consider it and perhaps Mr. Townsend would like to speak to it. It is a different approach to taxation, where at different levels of total income the exemptions would be given. Presumably a person has a different scale of life. We rejected this approach, but this did take into account the family or the total spending required. In our own thinking we rejected those particular approaches and felt we would deal with income flow, whether the two recipients are married or are single or are father and son. Perhaps Mr. Townsend would like to add something, because he is interested on this particular matter.

MR. TOWNSEND: This was the suggestion put to the committee by one of the members of the institute and it was made in some detail. Briefly, it recognized first of all that there is some level at which a person needs to keep all his income in order to meet day to day expenses. This would be a basic exemption available to everybody. I think in the particular proposal put forward this man would be around $3,000.00 or $4,000.00.

Then it was recognized that as a person's income goes up, there is another exemption or need for money which increases as a person's income rises. In other words a man with $10,000.00 income perhaps feels that he should have $6,000.00 to meet his expenses, whereas a man with $15,000.00 income, because his standard of living has increased, may need, say, $10,000.00.

So this second exemption was on a sliding scale and went up as the growth income or total income

went up.

There was a maximum on that second exemption of $15,000.00, as I recall.

I think it then develops a basic exemption, a secondary exemption on the sliding scale. The proposal was that the basic exemption would be an exemption which took the income of tax completely, the second exemption would end up a complete exemption and that this particular rate the income would be taxed at 10 per cent, and then the balance of the income would be taxed at 40 per cent. I think this was the essence of the proposal and of course it reduced a number of taxpayers considerably and reduced the revenue considerably. For these reasons, together with the fact that we felt the progressive rate structure, similar to what we have, should be retained, we rejected it; but it was an interesting proposal and one we spent some time looking at.

THE CHAIRMAN: I understand your discussion as to the advisability of a progressive rate structure and so on and the steps to it; but all I am saying is surely, if a family has two streams of income which are equal in size, it should be taxed the same as if it had one stream of income. Are you answering my question?

MR. TOWNSEND: No, I am quite sure this particular question is not really relevant to your question but since Mr. Little asked me to do it, I did it, because I think in the general discussion of personal income it is relevant; but I agree with our chairman's opinion.

THE CHAIRMAN: That this has little to do with it?

MR. TOWNSEND: Yes, in this case.

MR. LITTLE: You stated a moment ago that families on two streams of income should be taxed the same as a family with one stream of income. I thought you were addressing yourself to the question of splitting the income because of marriage state. What you are suggesting now is that two people with an income of $25,000.00, independent income, married, should be taxed as though they had $50,000.00 income. This would be unfair and a great hardship.

THE CHAIRMAN: I am quite willing to answer that question to me. I think the two questions are the same, whether you take the two people at $25,000.00 each and bring them together in matrimony and two streams are going to be taxed, or if you take the two streams, one with $50,000.00 and the other with nothing, in which case you have to have an appropriate rate of scale.

MR. LITTLE: One takes an entirely different approach to marriage, dependent on which you follow.

THE CHAIRMAN: That is perhaps so. I do not know. I suppose your argument is that the only neutrality is found when there is no change in the tax rate whether you are married or single, is that it?

MR. LITTLE: Yes.

COMMISSIONER PERRY: Is it not a question of whether you are dealing with a merger or whether the companies are associated with one another?

MR. LITTLE: That may be it.

THE CHAIRMAN: I have got your point. The next question I have is this. I think that in our discussion

before, it was indicated that there are two principles, two reasons for the issue of stock. One is to bring employees into the ownership of the company and the other is to give him remuneration at a low rate of tax. In the recent Bill before the United States Congress, there was a study made of stock auctions. I observe to a very large extent stock auctions when exercised, the shares did not stay with the employees, the shares were disposed of and the stock auctions were mostly serving as a means of providing an officer with tax free income or tax reduced income, to be more accurate.

Now, if that is what is in the main there, is there a point at which one can review personal income taxes which remove the need for any special treatment of stock auctions?

Would you seem to think that the maximum rate of 60 or 65 per cent is still desirable to have stock auction privileges in the Act, to have special legislation for them? I would think that at presumably some point it was unnecessary to have special legislation for stock auctions?

MR. LITTLE: I think that is perfectly right and I think really what we were doing and perhaps thinking was in the terms you have done. We were accepting the fact that the stock auction is here, but the treatment of it is much too liberal and does not make sense. If it is intended as an incentive reward it should be drafted to produce that result. I think it is quite right to say that if it were not for the effect of high rates of tax, an open incentive of this sort would be unnecessary.

THE CHAIRMAN: When is that rate of tax high, that is my question, would your 60 or 65 per cent knock it out of "high"?

MR. LITTLE: I do not think so.

THE CHAIRMAN: So probably at those rates the stock aucion rule is not necessary. That is the point I am getting at. I think there are undesirable features to it. It changes the normal law of the land and changes it when special circumstances exist, and when those special circumstances do not apply.

MR. LITTLE: There is no question at all that the stock auction privilege has resulted in abuse in this country.

MR. TOWNSEND: Presumably there would be necessity to get 65 per cent, but for the benefit of income it would be purely an election privilege which would be dropped.

COMMISSIONER GRANT: I should think the effect of your regulations would be tantamount to negativing the whole principle, because when you say that the price should be based on 95 per cent of the market price, then you withdraw the 20 per cent credit. Is not that an injustice to a person. If the person wants to buy stock on the market, is he getting any advantage?

MR. TOWNSEND: Yes indeed he is. If someone today, Mr. Grant, were given the option of one million shares of finbars nickel export, in the next twenty-five years, at today's market price.

COMMISSIONER PERRY: I am sorry, I thought it was at the date the option was exercised.

MR. LITTLE: No, at the date of credit.

COMMISSIONER PERRY: I misunderstood.

MR. McMACKIN: There is another attitude our committee discussed, which is hard to appraise if it is of importance. It might perhaps indicate that our recommendation is not generous enough to the holder of the stock option, and that is the competition, which is fairly intense and fairly hard in Canada. It is hard to ignore what is going on in Canada. I think it is right, but I have in mind that as long as these adjustments are held out in the United States, Canada should not go too far out of line with them.

THE CHAIRMAN: This is a very important matter, Mr. McMackin. I know that in the United States they are very concerned about the stock option, whether they want to see them knocked out, or not, I do not know. I think probably they are not going to succeed in this round, but most likely they are under the gun. We were talking about stock auction and I will stay at stock auction, something came to my mind about joint returns, your objection to the aggregation of income seems to be well taken. That chapter does not pertain to split income, does it?

MR. LITTLE: No.

THE CHAIRMAN: Therefore I say, with regard to the two streams and one stream of income into the same family, it is a pretty good argument in favour of split income, is it not?

MR. LITTLE: Yes, I think it is. I think that in our deliberations we concluded it was not necessary to

proffer this problem.

THE CHAIRMAN: Perhaps not unnecessarily but we are seeking equity and would it not be more equitable?

MR. LITTLE: I suppose that the only person who really in the end result would be affected would be the bachelor or the spinster, because if one assumed that all income earning profit was restricted to married couples, then the result would have to be the same because the end would require them to be the same and you would have simply different sets of rates attached to two returns, instead of a merger.

THE CHAIRMAN: But right now you have a great deal of uneveness as between one family and another, taking the proportion of income which is in the hands of one spouse as opposed to the proportion in the hands of the other spouse, and divided between the two; and the taxes are varying, dependent on the division of income between the two spouses. That would overcome that and it would also, as you say, be a redistribution between married and unmarried, but that is only part of the story of the redistribution. The other part is the eveness as between families, and I think this is perhaps very important.

MR. LITTLE: This is a question of degree and the importance which would attach to it. In our deliberations we reached a different conclusion.

THE CHAIRMAN: I guess I have shaken you out of that, and I can go on to the next statement.

You open up the question of deduction in respect of salaries of employees, on page 49. This is a very

important subject indeed.

Did the thought appeal to you that there might be some general round, some allowance to salaried employees on account of these expenses, rather than the deduction as specific expenses. I notice that in many of the countries there are such deductions and I would think they would be very expensive indeed if one allowed them. It is necessary to make a round sum or a percentage provision for employed people in order to equate them with self-employed or people in business.

Did that alternative occur to you at all in your deliberations?

MR. LITTLE: No, I do not think that it did, Mr. Chairman. I think, though, with your permission we might dwell on this point for a moment, I found after the session yesterday I was severely criticized by my members for changing the rules of play and departing from the conclusion we had reached. I think that under pressure from Mr. Coyne I had allowed myself to back away from my recommendation a little further than my members would have thought fit. I think Mr. Townsend, Mr. Lachance and Mr. McMackin would like to say a word. I think there are salaried employees with necessary and appropriate expenditures who ought to be considered.

THE CHAIRMAN: Very good.

MR. TOWNSEND: I think Mr. Chairman, that Mr. Little, under the questions from Mr. Coyne, suggested that perhaps the wording of our recommendation, taking a broader aspect of deductions for employees, suggested that perhaps we were in favour of limited exemption to

employees. I think the feeling of the committee is that our recommendation is worded the way it should be, that employees should be allowed to deduct any expenses in connection with their position, with the exemption of personal and living expenses and, I will think, transportation to and from work should come under the personal and living expenses, to avoid problems of that nature.

THE CHAIRMAN: Mr. Little tended to limit these beyond the words which you have now.

MR. TOWNSEND: That is right.

THE CHAIRMAN: Then, I would like to know how far you would go. We have had a recommendation from other bodies that uniforms should be deducted as in the case of airline pilots, and that the university professors' gowns should be deducted. I have asked these people if there was any financial sacrifice in respect of their having to wear uniforms and gowns rather than ordinary clothes. They have not been able to support that very well, but referred to the fact that entertainers are entitled to deduct the cost of costumes. Would you go so far as to permit the deduction of all uniforms -- because, if you did, you would encourage the use of uniforms to go to work.

MR. LITTLE: Mr. Chairman, I am not sure I could speak for the committee. I entirely agree with your suggestion that it would be ridiculous to provide that because a professor wears a gown he would be entitled. After all, he wears something quite different under the gown, and also the gown preserves it. As to me,

I am wearing a uniform. If I were not here today I would be dressed quite differently. I see no reason why I should deduct my clothing, and I see no reason why they should deduct theirs. It is simply a way of life.

THE CHAIRMAN: If you permitted all expenses except living epxenses you would have a difficult problem to decide whether a gown was a living expense or a business expense.

MR. LITTLE: And you would need a long series of regulations under the Act as to what were living expenses and what were business expenses.

THE CHAIRMAN: As I sit here now, I cannot see that there is much alternative to specific deductions in this area. Any broad words I think would cause endless trouble. Are you suggesting, Mr. Townsend, that we can get along all right with broad words?

MR. TOWNSEND: I think the committee feels there should be a general principle that an employee is able to deduct expenses in connection with earning his income, as a businessman or a mechanic. I think I quite agree that there will be difficult areas and that it is a question of drafting legislation which will not get into difficulties on this uniform type of thing. It may be that there will have to be provisions in the section which do exempt certain things as being living or personal expenses.

MR. LITTLE: I see no analogy between the airline pilot's uniform and a theatre costume.

THE CHAIRMAN: I do not think we need an awful lot of help there, Mr. Little, but thank you just the

same.

COMMISSIONER PERRY: We should send Mr. Little to talk to some of our witnesses, who were pretty serious on this point.

THE CHAIRMAN: On page 56, paragraph 161, you are talking about "income averaging". You indicate that the rule might be:

> "That the right to average be restricted to a taxpayer in cases where the taxable income of one year in a five year period exceeds by more than 100 per cent the income of any other year in that period."

I would have thought it might be preferable to have the income of any year exceed the average of three years in the period, or the average of two, or the average of the other four, or something of that kind. Is not any one year a rather weak thing to tie to, as one year may be a very low year. To relate the problem to a very low year might provide an adjustment which would be hardly fair. Is not that correct?

MR. LITTLE: I think that is correct. One can visualize a situation where you might so control your income that you produce an unusually low result in some cases, so that your income of another period would qualify. I think that is relevant criticism. I do not think we would have objected, had we thought of it, to put in 100 per cent in excess of the average of a particular period.

We are trying to pick out extreme cases, the

person who writes a book or produces a play, who struggles with very little income and suddenly has a lot of income in one period. Really, it is the result of endeavour, not in one year but over a series of years, that produced that book or play; so we try to put him in that position, the same as a person with a regular income.

THE CHAIRMAN: I am delighted to have this position, which salaried people before had been seeking. There is clearly a need for more averaging, for a lot of people, there is need for more averaging than there is now in the law, and this is probably a good way of getting at it.

MR. McMACKIN: If you take as the basis the average of two or three years rather than any one year in a period, it might then be desirable to reduce the 100 per cent figure to something somewhat lower.

MR. LITTLE: Or increase it?

MR. McMACKIN: Reduce it.

THE CHAIRMAN: I did not hear Mr. Little.

MR. LITTLE: If you take an average, obviously what you are doing is eliminating measurement of a very low year and smoothening it out and averaging two or three years, and I would have thought that to my committee one would have had to increase the tax rather than reduce it.

THE CHAIRMAN: I thank both of you very much, for both points of view.

Those are all the questions I have. Is there anyone else who wishes to ask a question?

COMMISSIONER PERRY: I have two or three short

questions. On page 46 where you recommend three methods of tightening up the reporting and taxation of investment income, do you have any preference among those three methods? I ask this, having in mind the storm in the United States when it was proposed and that there be a withholding tax on all payments of this sort.

MR. LITTLE: In this connection, as we pointed out in the paragraph preceding the (a), (b), (c) alternatives, we are not in a good position to assess how serious the problem is. We suspect it is the problem, but I am sure the Revenue Department would have a view in this connection.

We think it may be, and I think that if we had to choose we would come quickly to the conclusion that method (b) would be the one which would be most acceptable from the public point of view and from the administrative point of view less costly than (a), for example, which would increase the T-5 according to the flow of income.

I think (b) is the number one choice, if it were necessary.

COMMISSIONER PERRY: Thank you. On page 54, arising out of the cute little trick of family allowances, I wondered if I may put it this way. We have had a view, as recently as a week ago from the Canadian Welfare Council, that possibly all payments of this kind be taken into income. This would give a less severe adjustment than you propose here, where you propose that they be added to the tax.

If the other scheme were developed as part of

a money down rebate, or treatment of security payments, I do not suppose you would be adverse to that kind of treatment.

In page 56, paragraph 161, what is the reason for sub-paragraph (2), that is, the limitation of this provision, that is, the exclusion from it of people attending school or university.

MR. LITTLE: The obvious consideration of course is to prevent the person who starts to work in 1963 and has been at school for the past four years, and therefore for the four years he would be averaging annual income, from a taxpayer point of view; and by the same token a person who takes leave of absence for two years, say to attend a Harvard business course, would have no income for those two years. This is not the sort of situation we are trying to relieve.

COMMISSIONER PERRY: It is not? We have had many presentations from groups interested in one way or another in education, that something specifically of this sort be done. In fact, I recall the Canadian Medical Association suggested that the costs of an education be accumulated and allowed as a write-off over the first five or ten years of practice.

MR. LITTLE: I would think that I can sympathize with their point of view but it seems to me that one spends on one's process of education is ultimately reflected in one's income under that process. The person who spends four or five years on additional education eventually reaps the reward. Frankly, I think we would find it difficult to feel very sorry for the

person who, as a result of spending a little more money, earns more in the end result. Why he should ask for a reduction escapes us.

THE CHAIRMAN: The doctors hold this out as a bait to keep them in Canada.

COMMISSIONER PERRY: So you really have philosophical objections to any concession of this kind.

MR. LITTLE: Quite frankly -- I am speaking for myself now -- I would doubt very much that the medical profession leaves this country because they are not allowed to deduct medical education expenses. Medical people who leave any location for another really move, I think, because of the opportunities for research or doing some specialized sort of education they cannot otherwise do.

COMMISSIONER PERRY: I think their point was that this would provide some inducement to stay here and in effect provide complete freedom from tax for several years, and that this in itself might be an inducement to stay.

MR. LITTLE: This is true in respect of all taxpayers.

COMMISSIONER PERRY: Yes. Thank you.

THE CHAIRMAN: We are through with that chapter.

MR. COYNE: Mr. Chairman, perhaps we could turn to the next chapter, chapter VIII, on page 60, dealing with "personal corporations".

There seems to be no need to dwell on this page for any length of time. I was not proposing to ask you any questions on document Appendix G, which has been

available for some time and available to research staffs and others across the country.

MR. LITTLE: Mr. Coyne, I might just say in that respect that if changes such as we propose, or other solutions which others may propose, were adopted, and if it were necessary to adhere to the present corporation concept, then the recommendations that are contained in this appendix are really terribly important.

I wish to emphasize this to the Commission because the fact that we have not included them in Chapter VIII stems from the conclusion -- of course, you are accepting all our recommendations -- that if a solution is not found, then the personal corporation situation as it exists today is really most untidy and unhappy a situation and something ought to be done about it. We make this plea.

THE CHAIRMAN: I think this is one of the most troublesome single areas in the Act.

It is very difficult to find the right solution for it. Perhaps it requires a law extending beyond the income tax law. Certainly, within the Act, there should be some solution and in some way using corporation for the general purpose of corporations only and not to defer personal income. It is hard to deal with it.

MR. COYNE: I did not mean to suggest, Mr. Little, that appendix G was other than of the utmost importance if personal corporations were in fact to be retained.

MR. LITTLE: I am sure you did not. I want to emphasize the importance of these ancillory recommendations.

MR. COYNE: Then, if I might cite your main recommendation in this record, in paragraph 172, you say:

"In the opinion of the committee
the adoption of certain of the other
recommendations contained in this
brief, namely: ---"

and then you list the three recommendations which we discussed yesterday --

"would effectively eliminate the
need for the personal corporation
provisions. As a result, in
conjunction with the above listed
recommendations the committee
proposes the repeal of the personal
corporation provisions."

I wonder if you could explain briefly the reasons why you think that the recommendations would effectively eliminate the need for the personal corporation provision.

For example, just speaking for myself, I can see the point as far as dividend bearing securities are concerned, but what about the man who has a substantial bundle of interest bearing securities, for example. Would it not still be to his advantage, in the absence of personal corporation provisions, to form a corporation?

MR. LITTLE: I should explain that, so that everyone is clear, it is not the personal corporation that makes the problem, it is the personal corporation that ought to be a personal corporation but is dealt with

as an ordinary corporation.

MR. COYNE: I appreciate that.

MR. LITTLE: So, adopting whatever techniques there are, so that one may divert his personal income by way of dividends to what is his personal corporation which is not taxed as a personal corporation but as an ordinary corporation. So if he is free of tax he will pay at the corporate rate, whatever that is, the 21 per cent on $25,000.00 income. You can see or point, if we go to the flat rate, 50 per cent on dividends, which is withheld at the source, whether it goes into corporation or through the individual, it makes no difference. If it goes through interest, our suggestion is that you depart from the dual, then the person who directs the income into the corporation will pay the peak rate, which is 45 per cent, which otherwise might have been taxed in his own hands at the rate up to 60 or 65 per cent. It would depend on the level of his income, what particular rate it reached. But he would be required to face write off both 45 per cent on the income in the corporation and then to get it within the corporation he only has his two alternatives at this point. If he performs a service to the corporation, presumably he could draw salary or remuneration of some sort, which will take personal income tax. Or he could take by way of dividend, and then takes another 15 per cent. So if you pay a big corporate rate and pay 15 per cent on the dividend, our conclusion is that in most cases he might just as well have taken it direct in the first place.

The advantages of the corporation now, from the

corporation tax point of view, are very slim indeed. There will of course be a very important purpose for the personal corporation tax so long as personal estate and succession duty exists and presumably a personal corporation or a corporation will be used for that purpose. We think this takes out of the tax avoidance features that exist today.

MR. COYNE: Thank you very much. The phrase that really puzzled me a bit, and led to my question, was "effectively eliminate". As I understand your answer, you are saying in effect that at the moment there is a great big large carrot in front of the high income tax payer to put his securities in a corporation but this is prevented now by the personal corporation provisions. I interpreted your statement in this brief to mean that the carrot was being removed. Now you tell me in effect that it is not being removed but it has become a very small carrot.

MR. LITTLE: And perhaps no carrot at all.

MR. COYNE: Just taking your figures, supposing he pays 45 per cent rate in the corporation and 15 per cent on the balance by way of a dividend tax, the total of these rates is 52½. I suppose in that event the effective rate of tax on those securities would have to be more than 52½ before he would have any incentive to form a corporation.

MR. LITTLE: That is quite correct.

MR. COYNE: And not choose his marginal rate?

MR. LITTLE: That is quite correct. I think then it is 53¼ per cent.

MR. COYNE: Yes, of course it is. Is it fair to say that there might still be situations in which certain taxpayers would find it of advantage to put income earning securities in a corporation; but that you do not think these isolated instances would be of any significance?

MR. LITTLE: Yes, that is quite right.

MR. COYNE: What about the question of deferment of tax. Would that be a factor at all in encouraging people to form corporations, even under your recommendations?

MR. LITTLE: No, quite the contrary, there would be no difference.

MR. COYNE: This is because of the high flat rate of corporations?

MR. LITTLE: And the withholding of dividend on 50 per cent.

THE CHAIRMAN: The tax would only pick up that 50 per cent when distribution occurred. Mr. Coyne is saying that if the money is left in the company, would the fact that that 15 per cent is only payable on the distribution out of the company, not encourage people to defer their income or accumulate it in the company?

MR. LITTLE: No. Perhaps, Mr. Chairman, we did not make our recommendation here that the 15 per cent would be applied at the time the dividend is paid by the corporation which earns it.

THE CHAIRMAN: I am sorry.

MR. LITTLE: And if I pay my dividend into a corporation, the 15 per cent is held, whether it comes to

me or my corporation, it becomes tax payable, but at the source.

MR. COYNE: Varying the example, what about the case where the source of income is not dividends but income from bonds?

MR. LITTLE: Then we go back to your own example, Mr. Coyne, that if the corporate rate is 45 per cent, it is 45 per cent corporate rate paid on the interest immediately, instead of on the effective rate which might have been paid by the individual. One may quite properly suggest it is conceivable there is a difference to the top effective personal rate and this corporate rate. Our suggestion is that you narrow the gap to where it becomes insignificant.

MR. COYNE: It would become insignificant, in your judgment?

MR. LITTLE: That is right.

Let me qualify that. It becomes insignificant as far as revenue is concerned, as far as earnings across the border are concerned. One could pick out an example which would apply to an individual. Across the field, the matter has lost its significance.

MR. COYNE: That was the sense in which I expressed the significance which I drew from what you said, that some isolated case might still find it to his advantage to form a corporation.

Mr. Chairman, I was not proposing to ask any further questions on personal corporations, nor on the following chapter IX, "Special Provisions". I have one question to ask on the next chapter, which is headed

"Incentives". It is Chapter X.

THE CHAIRMAN: I have one question on special provisions, but I wonder if anyone has any on personal corporations? Since there are no questions, I may ask this.

I am concerned about the use of the word "concessions" there. The word "treatment" is used also there. You say:

> "Those which receive special treatment include banks, life insurance companies, municipal and provincial corporations, labour organizations, mutual insurance companies, credit unions, cooperatives, mining companies, crown corporations, etc.
>
> It is not within the scope of this brief to attempt to justify the various special concessions afforded one group or another. We do feel that certain of these provisions are unquestionably justified where they accommodate the special nature of the particular industry without adversely affecting other taxpayers, for example the special provisions applicable to banks and life insurance companies."

I think the word "provisions" is chosen there to distinguish that from concessions. There are certain

provisions now in order appropriately to measure an income without conceding any concession. Your paragraph continues:

"In other cases, such as cooperatives and government owned businesses, the question is much more complex -- "

So you are talking there as to whether it is a concession or it is not a concession. That leaves certain government owned corporations and a few other things which give concessions. Am I about stating it correctly?

MR. LITTLE: Yes.

MR. COYNE: The next chapter is Chapter X, "Incentives". We have touched on aspects of this in one or two other contexts. I find on looking at my notes that I have no further specific questions on this chapter, although at a later stage I intend to refer to the general statement on basic principles that appears with the first paragraph. I want to relate that in another context to another chapter of the brief.

THE CHAIRMAN: I find it hard to deal with incentives here, which mostly relate to capital cost allowances increases or things of that kind, without dealing with the capital cost allowances chapter which we agreed to set over until you get through.

MR. COYNE: That is what I felt, too, we were inclined to pick up the scientific research matter when dealing with that matter.

THE CHAIRMAN: I think we are going to deal with capital cost allowances after you get through and I

think we might just add Incentives at the same time.

MR. COYNE: Very well. That brings us to Chapter XI, entitled "Non-Residents". It is on page 66.

THE CHAIRMAN: This would be a good time for a short recess.

---A short recess.

THE CHAIRMAN: Now, we are ready to continue.

MR. COYNE: I was proposing to deal with Chapter XI on non-residents, which commences on page 66.

MR. LITTLE: That is right.

MR. COYNE: I should refer at first to paragraph 189 on that page, where you say:

> "We believe that the imposition of withholding tax on dividends to parent or other substantial shareholders in the U.S.A. requires particular examination, for the repeal of Section 2 of Article XI of the Canadian-U.S. Reciprocal Tax Convention in 1961, which resulted in increasing the withholding tax from 5 per cent to 15 per cent, as, in our opinion, tended to discourage Canadian development on the foreign ownership".

My question was simple. Was not that result exactly what was intended at the time the change was made, in December,

1961? One might quarrel with the policy, but would you feel that that was what the government of the day intended in introducing that legislation?

MR. LITTLE: I guess perhaps we should stick to the facts. I think all we can say is that it has tended to be that result. Whether that was the intention of the government of that day or not, I guess is incidental.

MR. COYNE: This is the actual result, this is a factual statement, that you are saying from your experience?

MR. LITTLE: Yes.

MR. KELSEY: May I suggest that the government that appointed the Royal Commission presumably did not share the view of the government that made this change, because in your terms of reference it is suggested whereby ---

(Quotation made from terms of reference, re encouraging Canadian ownership in Canadian industry).

There is a very important distinction there, between encouraging on the one hand and discouraging on the other.

MR. COYNE: It is a very good point. In the interest of accuracy, I believe that it was the same government that appointed this commission, that introduced this change in 1961 that we are speaking of.

Turning the page, to paragraph 190, you refer to the specific case of depletion in the forest industries, and you point out that the treatment in

Canada is less favourable than the treatment in the United States. You draw certain conclusions from that and from that paragraph I would like to put to you this general question, which perhaps you have answered in a way, in another context. The question is this.

Does the conclusion that you draw in this paragraph not get us to the proposition that taxing provisions in Canada generally must never be less favourable to the taxpayer than equivalent provisions in the United States.

MR. KELSEY: If I may answer that -- the point here was that in discussions with officials, as part of this study of modern companies, it was pointed out that senior people charged with investment decisions, often just look at the relationship between the charge for taxes in the United States and compare that with the charge in Canada. I think this is the point you are making, that if a man in a senior position is making the decision, it seems to him that the tax burden seems to be much higher in Canada than in the United States, where the decision is being made; and perhaps he is discouraged and deterred somewhat from favouring Canada, the place where the next investment might be made.

MR. COYNE: The result you speak of sounds to me to be very sensible, but does this, in your judgment, lead to a proposition that we in this country, in devising our tax laws, should attempt to ensure that in particular cases they are no less favourable to the taxpayers and the tax laws say in the United States, which is the only country perhaps one considers in this

context?

MR. KELSEY: As a general proposition, I think, yes. There may be cases where you are not as favourable in some area, but on balance the person looking at Canada from the outside, as a possible place where he might invest money, feels he might deal with me, on balance, as well as my own country or any country which I might suggest or select for this investment.

MR. COYNE: Would you regard this as a matter of first rank importance, in the construction of our tax laws?

MR. KELSEY: Of great importance, of first rate importance, yes.

MR. LITTLE: I think that is quite true. I think that we hold this view, particularly when we are thinking of the effect on (a) people who might leave Canada on the one hand and (b) investment that might be discouraged from coming here.

To give a precise short answer to your precise question, I think it would be wrong for us to say that Canada must model its tax system or rates on any other. What we are really saying is that, because of our geography or the extent of our people, and the free movement of our people, and, we would hope, free movements of capital, unless we pay great attention to the level of the United States rates, these other factors will operate, we will lose people, or we will lose money.

MR. COYNE: In other words -- and this is only one aspect of the general conclusion which you and others have reached -- we must pay careful attention to the

United States tax laws in devising our own?

MR. LITTLE: That is correct.

MR. KELSEY: Not only the United States but in some cases people who, say, are in the United States and are planning a new facility, a new factory. They may look at the whole world and say: "Now,where is it best to put this?"

We have seen cases where they have an opportunity to put a processing plant in Canada to process a raw material produced in Canada and they say: "That is all very well, but this is an easy raw material to ship to, let us say, the Netherlands, and we will get a better tax atmosphere in the Netherlands."

The tax differences may be an important factor in the decision to put that new facility in the Netherlands rather than in Canada. This is not selling out something we have already had, but it is something that is lost all the time, since those jobs we would have created in Canada are created somewhere else.

MR. COYNE: We are competing with other countries for the development of new plants?

MR. KELSEY: Yes.

MR. COYNE: Then, in paragraph 191, you state:

> "On the one hand, we believe that tax collections for Canada from the applicable withholding taxes are relatively minor. On the other hand, the taxes and other benefits which would flow from additional activity in

Canada are substantial, including increased employment for Canadians."

In the following paragraph you are critical of constant changes in the withholding tax provisions, which have a disrupting effect.

Looking only at your statement in paragraph 191, would you be in favour of repealing the withholding tax on dividends going to non-residents?

MR. KELSEY: Well, these questions are questions of degree, I think. At the 5 per cent level, the deterrent effect was not a significant one. This is a complicated web of international relations.

I do not know the answer to that question. I can only say that I think leaving it at 5 per cent is not, in our view, doing any serious harm. I do not know whether there would be advantage in repealing it entirely.

MR. LITTLE: One must differentiate as between the foreign individual and the foreign corporation, because here there was no thought at all that 15 per cent was wrong, 15 per cent withholding tax on revenue payments to non-residents in this country. Therefore there would be no change, and we had nothing to criticize. It is the approach to the foreign parent or corporation that was really the point.

MR. COYNE: That was going to be my next question, Mr. Little. Perhaps I could phrase it in this way, in the light of your comments.

Would it be fair to draw the conclusion from this chapter, and in particular the part of it we are

looking at, that the members of the committee are in favour of returning to the situation as it was before December 1961.

MR. LITTLE: I think that is fair.

MR. COYNE: That is in essence the position you are taking here?

MR. KELSEY: It is a reasonable state of affairs, I agree, in the view of outsiders as well as in the view of Canadians.

MR. COYNE: You feel that the advantages to be derived from that override the problems of foreign ownership and the like, which seem to be very much to the fore when these changes are introduced.

MR. KELSEY: There is no question of it. As a group, we feel strongly against the turn that the events have taken.

COMMISSIONER PERRY: Not as strongly as Eric Keirans did.

MR. KELSEY: Perhaps as strongly, but not as vociferously.

MR. LITTLE: We think as a group that the present approach to the use of the Tax Act to try to control foreign investment is wrong. We think, if it the policy of the government to try and effect the control of parent corporations, then there are ways in which it could be approached.

MR. COYNE: I am not going to ask you what they are, because it would be outside the topic.

MR. LITTLE: Perhaps I should say nothing more, but I think this is in the context of what we are saying.

One of the things that concerns us very seriously is the mere fact that a change in respect of withholding tax would affect those who are not here. We would obviously have less objection if there were some penalty imposed on the new person who comes to invest in Canada, but it is the treatment of those whom we have induced to come to Canada, to assist in our development, in respect of whom we now make a change. We think we destroy our good name.

THE CHAIRMAN: You suggest that the rules of the game have been changed on people who are already invited in?

MR. LITTLE: That is correct.

MR. COYNE: You say you are against theuse of the Tax Act for the purpose of meeting this problem of foreign control, if it is a problem. That is because you regard that as something which should be outside the ambit of the taxing statute?

MR. LITTLE: That is correct.

MR. COYNE: On the other hand you do not object, you are in favour, of using a taxing statute to encourage development of industries in Canada, not to discourage, for example, new American investment in Canada, even to the extent of, let me say, discriminating in rates of withholding tax between direct investors and ordinary security holders?

MR. LITTLE: Well I do not think it is fair to suggest that there is discrimination. An ordinary security holder who invests in Canada has no other source of income flow, in Canada, presumably, except, say, a

dividend earned, with respect to which he pays withholding tax.

A foreign corporation that brings foreign capital to Canada pays right off 52 per cent corporate tax. Our conclusion is that he is paying his way in this country, so if we go beyond that and then impose taxes which he cannot recover, against his own taxes, we simply result in higher taxes economy for him than in his own country.

I do not think it is right to suggest that we are discriminating between the corporation and an individual. It is quite the contrary.

MR. COYNE: Thank you ver much. Mr. Chairman, that completes the questions on non-residents.

THE CHAIRMAN: We have a few questions.

I think, Mr. Little, when we talk about taxation of non-residents, we have to look at both sides of this. You pointed out, it appeared to me, some discrimination in our laws, if I understand you correctly, in the non-resident investment.

I would think that one tax feature that the non-residents might find available would be lack of capital gains tax in Canada.

I suppose that recent actions in the United States laws have reduced part of the benefits that they can in one way receive. Because residents in the United States are now and always have been taxable, but now nationals and non-residents have become taxable on capital gains. Perhaps they were not always required to report them.

MR. LITTLE: United States citizens are taxed on capital gains, whether they are taxed as residents or as residents in Canada.

THE CHAIRMAN: Recently the reporting procedure has been altered, when they are non-residents of the United States. Would there be any advantage to foreign investors in Canada by the fact that we do not have a capital gains tax in Canada?

MR. LITTLE: There is an advantage, if their investment process is conducted through a corporation which paid resident taxes in Canada, but the ordinary individual who is resident in the United States, who reaps a capital gain in Canada, is taxed in the United States; so there is no advantage to him, if we do not tax the capital.

THE CHAIRMAN: But there is an advantage to somebody who has got a corporation in Canada and the corporation in Canada escapes capital gains tax which under other circumstances would be taxed.

That pertains to this item on page 67, where we were discussing the effect on timber lands.

I was curious as to whether you said that the depletion effect on U.S. income in the United States would provide that kind of an operation with lower income taxes in the United States than in Canada, taking into consideration the fact that there would be a 25 per cent capital gains tax in the United States and there would not be one in Canada to balance off properly the United States situation against the Canadian situation.

I suppose one would have to have regard to the

present value of 25 per cent capital gains tax, and the future income tax which would flow in the United States, and the future income taxes which would flow in Canada. Would that not be correct balancing one against the other?

MR. KELSEY: Mr. Chairman, I think the distinction here is that the consumer of the timber in Canada does pay full income tax on his realization. It is only if he sells, it is not consumed, that he has any benefit from the fact that there is no capital gains tax in this country. On the other hand, in the United States it is assumed each year that the man has sold and gets capital gains treatment on the value of the timber which he has consumed, and he is able to charge against income the full corporate rates, the full amount of that tax; so he is getting a break which is reflected in the rates of taxes, as shown in the reports of American timber companies.

THE CHAIRMAN: Then I am not properly following your point here. I thought that in the United States he was entitled to appraise the timber, to have it appraised, and if there was an appreciation he paid capital gains tax on that appreciation, of 25 per cent, without necessity for sale or transaction of any kind.

MR. KELSEY: That is right.

THE CHAIRMAN: Then the appraised value was ammortized?

MR. KELSEY: That is right.

THE CHAIRMAN: And the appraised tax would be more under the circumstances you speak of. As a result,

all income taxes would be lower. As against that, he would have paid the 25 per cent tax on reappraisal.

MR. KELSEY: I think one might do it this way, and say there was a reappraisal in the case of a piece of timber. Say it amounted to $1 million in excess of the cost to the taxpayer, granted he would pay that 25 per cent on reappraisal on $1 million, and that would cost $250,000.00. On the other hand, he would have a write off against current income of $1 million, which would save him 25 per cent, so he would be ahead $270,000.00. He would be that amount ahead of his counterpart in Canada who would get no benefit on the effect of that appreciation of that timber.

COMMISSIONER PERRY: The standard American practice is to reduce it by half.

MR. KELSEY: I made a survey of reported earnings of American companies and the degree of significance of timber operation as a factor in causing these to recover quite a large range -- the range of tax appeared to cover some about 22 per cent to something just short of 50 per cent.

THE CHAIRMAN: You have made a statement at the beginning, that the increase in 1961 in withholding tax, from 5 per cent to 15 per cent, has tended to discourage Canadian development under foreign ownership.

I do not quarrel with your opinion. Can you point to any evidence that there might be, or can you speak of any evidence in this? We have tried to find the best substantiation that is possible for statements of this kind, very important statements, is there

anything we can look to, to find support, or can you tell us?

MR. LITTLE: I find people are very reluctant to put themselves on the record as someone who has changed or has made an investment decision of this sort. Not to take anything in Canada, but to go somewhere else, there was a group of American paper producers, a week ago, and even they were reluctant to talk about their own affairs. I know for a fact other plant that has been located elsewhere because of this change in the Canadian withholding tax rate, because the combined overall rate on the product would be more than would be absorbed if they put the plant elsewhere, and they put it elsewhere. It is evidence of that sort.

I think it is not right to suggest that this happens every day or that we know a lot, but I suppose each of us knows people affected in this fashion, which entitles us to make the statement; but we cannot give the names of the people concerned.

THE CHAIRMAN: You are talking about 1961 legislation?

MR. LITTLE: Yes.

THE CHAIRMAN: What evidence is there at present to support a similar view with regard to 1963 legislation, because I think you have a similar view with regard to that here?

MR. LITTLE: I think that our thinking about 1963 goes one step further. It is that much worse.

THE CHAIRMAN: Is there any evidence that people who have made investment decisions which are

inimical to the business interests of this country because of 1963 legislation?

MR. LITTLE: I think so, yes.

THE CHAIRMAN: You think there is some evidence. You cannot tell us where we could look for it?

MR. LITTLE: No.

COMMISSIONER GRANT: Is the conclusion to be drawn from your comments with respect to the imposition of a higher rate of tax on the foreign owned corporation, that the institute does not see any great fear in the inflow of money and the establishment of foreign corporations in Canada?

MR. LITTLE: No, I do not think it would be safe for us to say that. I think that the institute, as all Canadians, would have preferred to see us finance entirely our own development over the past periods. That is, if we had a freedom of choice between developing the country ourselves or letting someone else do it, the answer is quite obvious. So we certainly are not suggesting that we prefer foreign ownership to Canadian ownership; but I think what we are saying is that we are recognizing that it is foreign capital that in large part has developed this country. Our real concern is that when we take steps such as we are taking in the 1963 Budget, if the end result is what the government announced as their aim, to divert Canadian investment to 25 per cent participation in foreign owned companies, then surely nothing could be worse. Why would we divert any amount of money -- say $1 million -- from a

Canadian owned corporation, or an English owned corporation, into a 25 per cent corporation with foreign holders in this country. It would have no influence on that at all. This to us is a matter of very serious and grave concern, that with the limited amount available in the country, instead of using it for new processes, new development, new research and participation in things we own entirely, we should make an inducement to put this capital into a minority position with a foreign owner. This to us is quite unthinkable.

COMMISSIONER GRANT: If the change in the convention or the change in the rate which brought about a repeal of the article of the convention with the United States, came about because the rate was increased from 5 per cent to 15 per cent, and if that rate were increased with the object of curtailing the flow of United States capital into this country, then your stand is that it becomes a question of degree, as to how high that rate should be. If it is decided to make it more difficult for United States capital to be invested profitably in Canada, then it becomes merely a matter of degree, as to how difficult you are going to make it. At 5 per cent, no one would object; at 15 per cent, perhaps nobody would object; although there was a change in the rules; but at 20 per cent now there is objection.

MR. LITTLE: Yes, that is right. That is simply because the recipient must look to the overall effective rate at home against which he can be offset.

THE CHAIRMAN: Your view is that the total tax on corporati..., when owned by foreigners, should not

be more than the total tax when owned by Canadians.

MR. LITTLE: If we want them to come here.

THE CHAIRMAN: And if we put the investment tax plus the withholding tax above the rate at home, then we are discouraging them?

MR. LITTLE: And if the right policy is to discourage foreign capital, this is the effective way of doing it. We think it is wrong, but more importantly we think it is wrong to apply this approach to the people who came here under the assumption, over a long period of years, because of our tax, that they could look to recover all tax and overall rate approaching 52 per cent in their own country.

THE CHAIRMAN: You would not be saying very much along this line if the 1963 legislation provided for a higher withholding tax applied to a return on new capital, when the new capital did not conform to certain rules which would be laid down, such as 25 per cent Canadian participation or whatever else it might be, but only with regard to new capital.

MR. LITTLE: That would be less objectionable.

MR. KELSEY: At the same time one must also look at the tax collections for Canada. Afterall, this is all under a scheme of taxation to raise the fiscal needs of the country. Even in that view, on the one hand, a relatively small increase in the withholding tax adds very little to the fiscal revenue of the country. On the other hand, if one is able to attrack to this country some activity that otherwise would not be here at all, the small amount of withholding tax that may be

lost by restraint in this area, is surely going to be far more than made up by the tax you would gather on salaries and wages of the employees of this enterprise which otherwise you would not have, and the corporation tax on the enterprise, which otherwise might not exist in this country.

COMMISSIONER PERRY: I wonder if you did not agree too quickly with the point that was just discussed, that this change in withholding tax rates applying to new capital. Surely they are just as effective in discouraging foreign investment coming in here.

MR. LITTLE: That is right but obviously less objectionable to us, because it does not apply to those who came under a different set of rules.

COMMISSIONER PERRY: I think what you are saying is that it is less immoral, but would have the same effect.

MR. KELSEY: It is still objectionable, but not quite as objectionable.

THE CHAIRMAN: Things that are not moral are presumably objectionable. I suggest that the objection is not only restricted to its effect on capital. Perhaps under these circumstances it might not be quite as effective in keeping out new capital, because conditions in regard to new capital would not have been there, and therefore new investors might feel the long range treatment of capital was a little more certain.

MR. LITTLE: That is correct.

COMMISSIONER PERRY: I am afraid we are falling into a decision that such treatment might not really have

much effect. It seems to me that it would be almost effective in discouraging further investment in Canada.

MR. LITTLE: Of course it would. This of course is a question of government policy. If the government in fact wishes to discourage any foreign investment in this country, it is very easy to do it. They may block it entirely if they choose.

COMMISSIONER GRANT: In your studies and your formulating, what you have said in Chapter XI, did you take into consideration the Canadian balance of payments position and the effect which this flow of interest and dividend from Canada to a foreign corporation, parent company, has on the balance of payments? I am assuming that the government is more concerned with this than it is with the fact that Canadians have not got too much of a say in how the subsidiary company is being managed, or the management policies; but their greatest concern is in connection with this outflow of interest and dividends and the effect it has on the balance of payments.

MR. LITTLE: Certainly, Mr. Grant, we considered and discussed it. We have no figures of course to present in this connection. Certainly this must be an area of concern to the government.

In the short run, of course, the effect on the balance of payments may be very adverse indeed. If the result of this is to start "to buy back Canada" obviously we are simply exporting our funds, and that is just as detrimental, in my view, as if we started to increase our imports. So we think the immediate result

of a decision such as this has an adverse effect on the balance of payments.

MR. KELSEY: There is a further point, that the type of activity which would be attracked to this country might be in the exporting field and might provide a continuing contribution to reserves of foreign countries.

MR. COYNE: I wanted to ask Mr. Little, arising out of the discussion, as to whether or not your objection to changes in the withholding tax rates, specifically to increases in the withholding tax rate, including the moral aspect of it, should not that principle logically apply equally to the corporation tax rate?

In other words, if you take the position that there should never be an changes or increases in tax rates, because foreign investors came into Canada under certain conditions which should not now be changed, are you not forced to take the view in effect that we must guarantee to foreign investors that corporation tax rates will not at any time in the future be more onerous than at the time the investor enters the country.

MR. LITTLE: No, I do not think that would follow. It seems to me that the rate of corporation tax and the personal rate of tax applying to citizens in this country must properly be very close to revenue requirements, and as that requirement changes, as our economy changes, as our spending changes, presumably the rate must go up or down.

I can see no objection to imposing a higher corporation tax, if it applies to all residents of the

country at the same time. This is not in our view a revenue producer. It is an item of control of inflation, and to some extent of the flow of money. We look on this really as a weapon to be applied, not as a revenue producer. There is of course great logic in what you say, that if we pursue this to the end result, you could bring it about through the American company coming here paying 52 per cent over all, saying "You will not have to pay a higher rate, no matter what happens?". Perhaps to this extent we are not really consistent, but we do not go that far.

MR. COYNE: I take your point of distinction on the revenue nature of the tax, which is very logical.

In the next chapter, Chapter XII, on "tax havens", I did have one or two questions but they are all of a rather minor nature and with your permission and unless you wish to pursue that aspect of the subject, Mr. Chairman, I would suggest going on to capital gains tax.

THE CHAIRMAN: I would waive, if everyone else agrees. Very well.

MR. COYNE: Mr. Little, perhaps I could introduce the subject in this way. You come to the conclusion, stated at the end of Chapter XIII "That a capital gains tax should not be introduced in Canada".

But if you will refer back to page 62, at the top of paragraph No. 178, you state five basic principles which you considered desirable in a good taxing system. These are, first, that the taxes should be applied on the broadest possible base; secondly, that they should

not discriminate as between taxpayers; currently they should be simple and readily understood; fourthly they should be applied with the greatest possible equity, with the fewest possible exemptions and exceptions; and fifthly, they should have regard to capacity to pay.

Now, I put it to you that in considering a capital gains tax in relation to the basic principles of a good taxing system, that at least as far as four out of the five principles are concerned, a capital gains tax might seem highly desirable -- certainly as far as equity and capacity to pay is concerned -- you refer to this in paragraph 202, where you state:

> "On the surface it may seem reasonable that increases in wealth through capital gains should be taxed since other forms of increase are now being taxed. Certainly an increase in wealth indicates a capacity to pay, and the capacity to pay is an important factor in equitably distributing a tax burden as heavy as we have in Canada".

Looking at the other principles, that taxes should be applied on the broadest possible base, they should not discriminate as between taxpayers, I would have thought, on your own reasoning, that a capital gains tax would meet these principles.

The fifth one, which possibly is the one which a capital gains tax would be difficult to meet --

is the third one, that they should be simple and readily understood.

Perhaps I could put it to you this way, would it be fair to say, on your own reasoning, that it is the fact that a capital gains tax would not be simple and readily understood -- and I incorporate in that concept this problem of administrative difficulties -- which perhaps we will discuss in a little more detail later -- that that really is the only logical objection to a capital gains tax?

MR. LITTLE: That is a very long question ---

MR. COYNE: I am sorry. I am afraid it was. Do you want me to repeat it?

MR. LITTLE: I do not ask you to repeat it, but allow me to pick it apart bit by bit; and, for the record, disassociate myself with what you seem to be asking me to say.

In the first case, when we talk about taxes being applied on the broadest possible base, I do not think this should be intended to imply that one must reach out and tax every conceivable thing. If you take that construction, we should tax in some way other objects, wealth and position and so on. It does not seem to me that any suggestion we are not taxing capital gains, we are not taxing on the broadest possible base. This is the first point.

I do not think that is a valid reasoning in support of capital gains.

MR. COYNE: I do not want to interrupt, but might it be fairer to say that that principle in the

concept of taxation must be tied in with other principles relating to capacity to pay and increases in wealth?

MR. LITTLE: I am coming to that. In respect to the tax you do apply, then you apply on a broad base. If we are going to take in Canada, we do not tax half the people but the whole people. If we are going to discriminate between tax people, we do not tax anyone who has a capital gain, so there is no discrimination. If you do not have a capital gain, you are in a different position from one who does, and from a tax point there is no discrimination. So far as simplicity and ready understanding is concerned, this is one we must come back to, because it is one of the most serious factors in this area and should be applied with the greatest possible equity.

Obviously, if we had a capital gains tax, we should apply it equitably, but we are not suggesting otherwise.

Finally, we should have regard to capacity to pay. On this point, in paragraph 202, obviously if the funds are there, one assumes one has capacity to pay. This is equally true of the man with $1 million who has not a penny of income and may even have capital losses. The fact is that at the end of the year he has $1 million and I have nothing. He has capacity to pay. If this is the approach, this leads you down the path towards tax at the end of every year on wealth, as some countries do.

We do not accept that this is a reasonable approach to taxation. We have accepted the concept of

taxing income flow, and this in our view is not income flow. I do not know how long an answer you would like to your question. You have more questions, I assume.

MR. COYNE: Perhaps we could have something in the dialogue, it might be easier for both of us; but I do not want to interrupt you.

MR. LITTLE: Just to speak briefly, then, on the other aspects of this. In the first place, we are very concerned that the revenue that might be produced by such a tax in this country, if it were imposed on any reasonable basis, would be quite out of keeping with the cost that would be assumed, not only by the government but by all the taxpayers of this country, in attempts to comply; and that as far as revenue producer is concerned, and of course we are guessing in this field, because it is conjecture as to what a capital gains tax might produce, we of course look to the United States as an example.

In the United States the capital gains tax is producing I think something like 4 per cent of the total revenue. Therefore, in our view this is not a major factor, but more than that of course, their capital gains tax has been in existence since 1913, so there is presumably a tremendous backlog of appreciation, which is taxed every time something turns over.

If we had a capital gains tax in this country, it would not reach into the past and start afresh, and could only start from the date of imposition forwards. We would assume that. If you take that, one must assume that revenue flow is much

smaller than the revenue flow would be x years from now, so from a revenue standpoint, if you are trying to solve the problem of the Canadian economy today, with these continuing deficits, that this is not a solution which will mean very much.

We are appalled at the thought of the administrative cost and procedure that presumably would be involved, by all the taxpayers as well as by the crown.

It is easy of course to say that they do this in the United States and that it works and we see it in operation.

While the extent of the sections in their law deal with capital gains may not be so overwhelming, but the fact of the matter is that in almost any taxation problem that you look to in the United States, there is the underlying problem of the capital gains feature. I think it is safe to say that all of us who have anything to do with it know that the United States taxation are impressed by this fact, and we would strongly resist introducing this sort of problem into our taxing feature. So we just fail to see what really is the justification for thinking in this direction.

MR. COYNE: Let me, if I may, just pick up some of the remarks that you made, which will lead logically to some questions.

First of all, on this question of capacity to pay, I do not think I quite understood the examples you gave, of the man who had $1 million but had no income from it and indeed suffered losses during the year. I do

not think in this context we are suggesting that he would pay, or that anyone would suggest that he had made a gain which would be subject to tax. He has not made a gain in the circumstances, has he?

MR. LITTLE: No.

MR. COYNE: On the other hand, the man who has $1 million at the beginning of the year and has $1½ million at the end of the year, he has made a gain.

MR. LITTLE: That is quite right.

MR. COYNE: We are referring, I think, to capacity to pay in relation to gains of one sort or another which taxpayers may make. In other words, we are talking about a gains tax, not a wealth tax, at the moment.

COMMISSIONER PERRY: Perhaps we are really discussing realized gains.

MR. COYNE: I do not know that that is not necessarily unfair, but when Mr. Little was speaking to capacity to pay, he seemed to relate it to a man's wealth, rather than to a man's gains. I wanted to make sure we were not talking about a wealth tax but about a gains tax. It would be a question whether unrealized gains, as well as realized gains, might be taken into account. That is another question and I prefer not to get into that at the moment.

MR. LITTLE: I do not think we should be too narrow in this approach to capacity to pay. If we look at it in the sense of capacity to pay, surely if you have $1 million and I have nothing, you have greater capacity to spend than I; on any subject, whether it is

taxation or anything else -- in that sense you have capacity, I did not have capacity, simply because you have more than I.

MR. COYNE: Yes, but again I am taking the same point that you made, in commencing on your principle No. 1 here, about taxing being applied on the broadest possible basis. We are discussing these principles, I take it, in relation to particular kinds of taxation. I certainly have been using the phrase "capacity to pay" and I think you were also on page 62, in relation to capacity to pay out of gains of one kind or another which a man earns, whether through income as under our present system, or in the context we are now speaking of tax gains.

I do not think that this rather philosophical or meta-physical argument, is worth pursuing, and if I may, I would like to take up another point that you made. That is, on the question of discrimination. You said in effect that you did not think there is any discrimination because what we are taxing is income, and capital gains are not income.

That of course is a fair statement, if what we are talking about is income as we now define it for taxation purposes.

I suggest to you however that it is at least conceivable, and indeed logical, to think of gains in a far broader context than merely income as we now know it, and that one can very sensibly suggest that there is discrimination against the man who happens to make his gains in the form of income, as compared with the man who

happens to make his gains in the form of capital. To the extent the discrimination has no meaning in this context, surely that is what we are talking about.

In the United States, their structure admits that capital gains -- in fact, as I recall the Act, capital gains are income in the United States, they are taxed at a special rate, but nonetheless they are income, any gains are income. Can one not suggest that by separating one type of gain from another as we do in this country and taxing one and not the other, there is discrimination?

MR. LITTLE: If you speak of a gain in the sense of a trade gain, and there is an area here that I think ought to be dealt with -- but if we are talking of purely appreciation of capital, capital gain of this sort, then I do not think there is any parallel between the two. If we tax income, or tax capital, or tax both, I do not think it is fair to suggest that because there has been an increase in value or change in that value of the dollar, which is the most significant of all, that one has something that has to be taxed.

This is in respect to the point Mr. Commissioner Perry raises, which we have dealt with, what is the difference of the position of a man who turns up his portfolio over the year as it goes up from $1 million to $1½ million, to the person who simply sits on his $1 million or $1½ million. You are saying that the person who changed papers suddenly had a capacity to pay, that the person who did not change does not have. What is the difference in capacity?

MR. COYNE: I suppose we would have to admit that no tax is perfect, but, taking up your point, which I appreciate, how would you relate what you are now saying to, let us say, your recommendation of a flat rate of 15 per cent on all dividend payments or other corporation distributions. That is one of your recommendations. I suggest that it offends against both the progressivity feature and the capacity to pay feature. In fact, it may not be a bad idea, in fact it may be a good idea. I simply put this forward to suggest that no taxes are perfect in relation to principles, and all of them may of necessity offend against one or another. Perhaps you would comment, why are those principles of such great importance in the field of capital gains, taking as your illustration realized gains, as against unrealized gains; and relatively little importance say in relation to taxation of dividends?

MR. LITTLE: I do not admit of course that that is the position that we take, or that we are not attaching importance to it.

If you go back to our approach to the taxation of dividend income, when you recall that our conclusion is that the revenue loss in this respect has been very small.

MR. COYNE: I am not talking about revenue losses.

MR. LITTLE: We were, because our whole concept is that taxation is to produce revenue and if it does not produce revenue we should not have it. That

is one of the things we put about this tax, that it is very costly and difficult to administer, and we think it will have other features that discourage it. That is what appalls us -- the net result, if you measure the cost of raising it against the revenue that you may receive. What is the gain? If you are talking of capital gains of 25 per cent that might produce $100 million, it is a different thing, it might produce that. Supposing it is $500 million, then our whole argument loses force. But we say this tax probably will produce less revenue than the estate tax, which is a minor revenue producer and unimportant. We say, why burden ourselves with administrative cost and complicate the whole machinery of operations, unless some real win is there. If there is no win, we should not have the tax.

MR. COYNE: Have you made any kind of study of what increase in administrative cost that might be? Certainly, the imposition of any new tax will introduce new administrative costs which were not there before the cost of administrating the tax. More assessors will be required and the like, there will be more record keeping on the part of investors. Of course, several of your other proposals involve more record keeping on the part of taxpayers, for example, the extention of the federal sales tax to the retail level would involve this.

MR. LITTLE: Mr. Coyne, we already have a sales tax at the retail level.

MR. COYNE: In most provinces, but not all.

MR. LITTLE: All but two.

MR. COYNE: My question is, have you made any study at all of what the increase in these administrative costs, from either side, might be?

MR. LITTLE: No, we have not, and I do not think anyone can. I think the revenue authorities might, by studying what has happened in the United States, be able to make some fair estimate of what they might have to do in respect to their staff. This is conceivable, though it would be a small part of the total cost.

One might not blithely set aside that there might be some increased cost to the investor. It is not just the investor. Every person in Canada, every one of the Board members, and all of us here, would now have to report the cost of everything we own. We would have to keep an account of every transaction, of any investment you held, and you must own some. There is a capital gains feature that may go up. I suggest the burden on the taxpayers; and the burden on the profession -- though it is not exactly a burden on the profession -- is one of the things that appalls us. What appalls us as a profession is the fact that so much of our time is devoted to entirely unproductive effort, instead of being useful to people and helping them to produce and earn. Instead of that, we are fussing with the tax laws of this country. It frightens us to think we would have to deal with this problem also.

MR. COYNE: Just turning to your specific objection as to the disproportionate relationship, as to what you think the cost of the capital gains tax is,

against the potential revenue from such a tax, would you apply this same thinking to any other tax. In other words, is a tax a good tax or a bad tax depending solely upon the relationship to revenue expenses?

MR. LITTLE: No, we have applied this, as you will see, and we are making the point, both in the introduction and in the chapter on estates tax, this is not a good revenue producing item.

MR. COYNE: Neither is the income tax on farmers, Mr. Little.

MR. LITTLE: That is quite right, nor is it good revenue production on people of less than $1,000.00. But the estate tax, we make the point, we think it does serve a purpose, other purposes, in the economy, the fact that revenue from it is relatively small. We admit that is a disadvantage, and one might scrap it if that was the only purpose. But surely there are other purposes? We cannot attach, in our view, any such ancillory purpose to the capital gains tax.

MR. COYNE: In other words, in your view the capital gains tax does not perform any other such function?

MR. LITTLE: No.

MR. COYNE: There is one other relatively small point. You referred as one disadvantage of the capital gains tax the escape of wealth systems to tax havens. If there were to be capital gains tax, would you be in favour, in order to meet that situation, of a type of provision similar to that which you recommend on page 28, having to do with the change of residence

of a corporation. In other words, would it be appropriate to deem a realization at the time a person becomes a non-resident of Canada, in order to avoid some of the implications you speak of here?

MR. LITTLE: This is purely a minor point of the problem. You ask me if we had a capital gains tax would we approve of this sort of approach. I hesitate to say anything that might indicate we would approve of a capital gains tax.

MR. COYNE: No. I realize your position is perfectly clear, but it might be of some assistance to have your views, if you would care to give them, as to one or two aspects of the matter. If there were a capital gains tax -- afterall, neither you nor I is going to determine this matter ultimately.

MR. LITTLE: That perhaps is unfortunate. I do not know how you could resolve that question, unless you go back to Mr. Commissioner Perry's question, as to whether you are going to tax it as it appreciates, or only when it turns over. You are obviously suggesting that if a wealthy person leaves Canada, should we assume a realization at that point?

MR. COYNE: On page 28 you make some other sensible suggestions as to how to avoid the escape from taxation, by corporations changing their residence with undistributed income they might have at that time. I am merely asking whether the same principle might not logically be applied in relation to capital gains tax. Perhaps, if you like, I should make it more specific and say, assuming there is only capital gains tax on

realized amounts.

MR. LITTLE: Make it more general. If we had a capital gains tax, obviously there ought not be loopholes through which one can escape. On page 28 we record two loopholes through which one may escape on taxation. If one escapes through crossing the border, this fault should be cured.

MR. KELSEY: Is there not a fault there? When a man leaves Canada, the question of capital gains tax is perhaps not as important as the fact that the Canadian estate of that man has in effect died and perhaps he should be dealt with somewhere in the Estates Act rather than attempt to work through capital gains.

MR. COYNE: The position could have general application to a number of different circumstances. I wonder if we could pass it for the moment and go to the positive recommendation in this section, if I may call it such. That appears in paragraph 216 and it reads:

"That every effort be made
by the Department of National Revenue
to seek out and tax gains which are
in the nature of trading or business
venture gains, ---"

What I would ask you to comment on is how far do you think the Department should go in this searching for these trading gains. Let me just put one example, but others will come forward. If they are to pursue aggressively this policy of taxing as income these particular gains, should, for example, they review all stockbrokers records once a year or what specifically do you have in mind here?

MR. LITTLE: I think all of us in the profession are aware of this point. I think it would be quite unthinkable of us to come here and name even types of industries or professions concerned.

MR. COYNE: I think we can be a little more open than that. Surely security trading is a field in which there are problems of this nature?

MR. LITTLE: I think that is correct, but I think it would be quite improper for me to place on the record of this Commission that the Department of National Revenue should approach stockbrokers, for example.

MR. COYNE: I am sorry, I did not mean that. I thought what we were talking about was profits, whether perhaps of a trading nature, not the stockbrokers who are taxable now anyway. It is in regard to those things which are not taxed simply because the Department does not obtain any information with regard to such transactions.

MR. LITTLE: I think that is right.

MR. COYNE: Would it be fair to say that in order to obtain information about share transactions, if only for the purpose of determining whether or not it was trading, it would be necessary to adopt some such measure, for example, as examining the records of stockbrokers?

MR. LITTLE: It seems to me, with the greatest of respect, that you are leading me into an area which is quite foreign to the terms of reference. We are dealing with the scheme of taxation and the things that ought to be taxed. I do not think that we ought to be

concerned with the way in which the Department of National Revenue would so organize its affairs to tax the income. Surely they must know if there are areas that are now escaping tax? Surely they are as well aware of it. All we can say is that there must be fairness, that you do not tax one trading and allow others to go free. That is simply our point. You know how the Department should look at it.

MR. COYNE: It wouldbe interesting to know. You say "every effort" should be made; but in your comments on that, it is obvious to me that the reason you say "every effort" should be made is that every effort is not being made, as of this moment and some types of trading profits are being assessed and others are not being assessed. It would be interesting to know in what way this may be covered.

MR. LITTLE: I think you sum it up beautifully. You state the point, that there are some accounts being taxed and others not being taxed; but it is not for me to suggest whom one should look to or how you should get it.

MR. COYNE: May I ask this question? You are talking about gains which are in the nature of trading or business venture gains. Do the members of your committee feel that any clarification is necessary in the present law to guide the courts in this area, as to what is or is not a venture in the nature of trading?

MR. LITTLE: No. I think our conclusion was no amendment of the law is necessary.

MR. COYNE: Then let me put this to you -- or

perhaps it is a quasi legal question, if you like, and you can treat it accordingly.

In the jurisprudence in connection with this matter which has developed over the last fifteen years, amongst other developments there is a doctrine which I am sure your members will be familiar with, the doctrine of secondary intention, as a guide to determining whether or not a particular gain arises out of a trading venture or not.

If such a doctrine continued to develop by the courts, I put it to you for example that it might result in virtually all stock market gains being taxed as income. Is this something which you would approve of and, if not, do you do not require some change in the law from the present law?

MR. LITTLE: Perhaps if you would just go on and delineate for me what such a change might be, I would be in a position to comment.

MR. COYNE: This might waste everybody's time, if we got into drafting, but all I am posing for you is really this.

If the present law, to the extent that it has been clarified by the courts, were applied across the boards, with the full vigor that you specifically recommend, then the inevitable result if you like is that a great many gains are going to be taxed which have not heretofore been taxed -- and specifically at least, on one view of the law as it stands at the moment, I suggest to you that all gains by anyone in the stock market will be taxed as income. Now, let me put it to you this way,

would this be a good thing?

MR. LITTLE: I do not accept that, so I do not say you could say whether it is good or bad. Nor do I see it that way. Let me say I must not comment on the law of secondary intent. That comment I suppose would come better from the Bar Association.

We have seen over the past ten years a good deal of clarification through juris prudence as to what is a gain and what is not. To the extent that trading gains are now in existence and not being taxed, they ought to be taxed. We do not object to this at all. To the extent that an interpretation might assist to impose a tax on something which is not a trading gain, or is not in the nature of trade, but is simply capital appreciation, then we object.

MR. COYNE: I understand your point, but it begs the question to some extent. Let me see if I understand you correctly. Your position is that all trading gains should be taxed?

MR. LITTLE: That is correct. I was not being impertinent. I can assure you that I am answering, and not begging the question.

MR. COYNE: You suggest that all trading gains should be taxed but something which is not a trading gain should not be taxed. Then it leaves the whole question as to what is "trading".

MR. LITTLE: Quite right.

MR. COYNE: I take it from what you say that your position is really this, that all trading gains in your judgment should be taxed whatever their nature and

that as far as the members of your committee are concerned the present laws relating to the definition of trading are satisfactory and you recommend no changes.

MR. LITTLE: I do not think there is any law that defines trading, Mr. Coyne.

MR. COYNE: I think there is a series of cases which determine the meaning of the word "trading" in relation to particular circumstances.

MR. LITTLE: Quite right.

MR. COYNE: And one can perhaps draw certain general principles tentatively from the cases.

MR. LITTLE: That is right.

THE CHAIRMAN: I would like to raise one or two points in this connection and perhaps others have some questions also. The thing that I believe is of extreme concern is that there are subjects which we have been hearing, namely, speculation -- and I would think that we must explore that to the fullest extent.

European countries mostly have got taxes which they generally say are not taxes on capital gains, but they are taxes on speculation. They usually have a time test and it varies in different countries. It is not quite the same. The United Kingdom has recently moved to a law in this area, again, to present the views of their house as not being a tax on capital gains but on speculation. The reason, they explain, was that their law was not good enough to get after speculative profits, without change.

You have said, I believe, Mr. Little, that our law is good enough to take care of speculative profits

in the securities area, without a change in the law. You obviously do not believe that is being accomplished now, or you would not have drawn attention to it as you have suggested.

I wonder if, despite what you say, there may not be some room for believing the law might be improved to bring this into tax and also provide greater certainty. Why not a time test as there is in England, or, if the time test, which is a flat two years or three years or six months, is too sudden, there is also the Swedish time test which is graduated and planned, whereby so much of the gain is brought in at the end of the year and so much more or less at the end of two years, three years, and so on, until after five years none of the gain is brought into tax.

Did you consider the possibility of applying any time test to this type of transaction so that some would be brought into tax almost automatically and others left again almost automatically.

MR. LITTLE: Yes, we did. Now, referring back to the British situation, first of all, I do not think we would agree, with deference to the law, that the British law was not good enough. I think personally that the British took the easy way out of the difficulty of the assessing problem. In my view the application of the time feature to all transaction is simply taking a shock approach, to make sure you get everybody.

In that process, you must be taxing a great variety of things that have no relation to tax at all. Take the case of time, in regard to six months -- you

may invest, and at the end of the day you may choose to reinvest, and you hold for a week, instead of six months. It seems to me that the time test is a purely artificial approach to the problem. It sweeps in every transaction within that period, simply to make it easy for the administrator's to make sure nothing escapes. I think this is wrong. I think that to approach taxation in this way is not the proper way.

I think that without a great deal of additional effort, our National Revenue people can do a better job than they can do. Certainly, they have gone a long way the last ten years. I do not think we put this forward as a major point. It is true, it is a recommendation at the end -- simply because it is a fact that there are things that people like to think of as being capital gains today, that are not capital gains. Some people are trading, and we think they ought to be taxed.

THE CHAIRMAN: Would it be grossly unfair to impose information with regard to capital transactions. The responsibility would be on stockbrokers then to secure knowledge as to who was buying and selling securities.

MR. LITTLE: I do not think you could say that would be unfair, but it would be administratively expensive, for what it was worth. I could not say; we did not consider it, Mr. Chairman. It certainly would not be unfair.

THE CHAIRMAN: That is all I have.

MR. McMACKIN: Might I say a word. In regard

to sweeping all the stock market profits or gains -- and I think we are talking in terms of realized gains -- there are a great many cases where, in my opinion, just speaking for myself, the realized gain is an illusory one.

For instance, John Doe buys the stock of one of the banks at $1.40. His friend buys stock of another bank which happens to be sold at the same price. A few weeks or a few years -- I do not care -- they are both at $1.80. John Doe sells his bank stock at $1.80 and uses that money to buy at $1.80 the same stock as his friend bought before him. That goes on to the line. I believe that a great many investors, perhaps not the cleaverest investors, do this; and the net result is that they only swap horses. All that happens is that two brokers get two brokerages.

It seems to me that gains of that sort, unless the man realizes his asset and invests his money in something of an entirely different nature -- and I do not know what I mean myself by entirely or where we should draw the line -- in this case into something different from essentially the thing that he was in already, there has not been a change in the nature of the investment and there has not been a realized gain -- at least that the two transactions are concurrent.

THE CHAIRMAN: I think, Mr. McMackin, you are pointing out the whole difficulty of this area and the need for perhaps an objective test.

MR. McMACKIN: That may be so.

THE CHAIRMAN: Certainly, if there is a test such

as a time test, it is going to be a rough test and sweep in people who should not be there and leave out people who should be there. But it will be a line of demarcation. I think what you are saying is that without that test it is almost impossible to tell who is really turning over their investment to seek a gain, and who is really trading in portfólios for an investment. And the measurements right now, as established by the courts do not extend very far in the area of securities and might cause a lot of difficulties. Am I not right?

MR. McMACKIN: Yes, I think so, sir. The courts indeed might find it very difficult to apply the principles to the stock market transactions, that they would have apparently thought to apply to real estate. At the same time I agree with Mr. Little --- or, if I put this as my own view, I do not say it should be done, but if these things are to be pursued and if an effort is to be made to bring them into tax for the purpose of income tax, then there will be resistance and there will grow up a body of juris prudence which will seek necessarily to try to draw a line. Difficult as it may be, and numerous as the cases might be for a while, it still seems to me that it is the function of the court to draw that line, based on whatever they consider are sound legal principles, which I suppose are mostly on intention.

THE CHAIRMAN: You prefer to have the courts do that, rather than have the legislature proceed. Their job is to define the law, to proceed to make rules, which

you do not believe can be as good rules as can come out of juris prudence?

MR. McMACKIN: I think that in drawing these rules you are having to give the subject the right to have his position decided by an impartial court.

MR. LITTLE: I do not think the problem is as difficult as one would assume from the discussion which has gone on. I do not think there is any difficulty, either, in describing a trader, or in being able to conclude the real trader, the man who really is trading; nor is it difficult at all to look at the person who is really investing and doing nothing but investing and periodically and prudently making a change.

It is the grey area we are talking about in between, where it is difficult to decide. What we are sure is wrong is to take a shock approach and put an arbitrary time limit forward that would sweep up everyone in the grey area, and beyond that delimiting, open the problem over again. We think that by pursuing the courts they have done, by being a little more diligent in this area, the Revenue Department itself can close up this gap.

THE CHAIRMAN: I suppose it depends on the size of the grey area.

MR. LITTLE: That is right.

THE CHAIRMAN: If I consider myself, sometimes I am black, sometimes I am white, sometimes I am grey, in any sales of securities; and I think probably grey would predominate. I am not really sure.

MR. LITTLE: Red, it might be.

THE CHAIRMAN: I do not think it is easy, myself. If no one else wishes to raise a question, let us move on.

MR. COYNE: The next section is Chapter XIV on "Gift Tax". Perhaps I might raise one or two questions, as time is moving against us.

MR. LITTLE: On page 75 you raise a very interesting suggesting that gift tax should be imposed on gifts, not only to those persons resident in Canada but also persons domiciled in Canada. This of course is getting away from the income tax concept, and the Income Tax Act in which the gift tax provisions happen now to be; and getting closer to the Estate Tax Act, where perhaps you feel the gift tax provisions might more logically be. Is that implied in your recommendation?

MR. LITTLE: That is definitely implied. We see a great corrolation between gift tax and estate tax, and we think it is a perfectly fair one, that if one gives something away prior to death it should not escape tax because of the time factor. Therefore, we recognize the gift tax as certainly useful for proper purposes. We see in this question of taxing on the basis of residence and not on domicile, an escape hatch and it would be perfectly easy for a person to move to New Zealand and be resident there for a spell of years and give away all of his estate to residents of Canada, and come back. This to us is a loophole that is not warranted. There is no change in the philosophy, we are trying to close the gap.

MR. COYNE: Have you given any thought to the

locating and taxing of persons not residing in Canada and not domiciled here -- domicile is difficult to compute, as you appreciate. The problem is sufficient, I am told, in the case of estate tax. Despire the provisions in the estate tax conventions and the like, the notion of finding a Canadian domicile when he is alive might be terrifying to a tax collector.

MR. LITTLE: I would think it would not be terrifying to a tax collector, because he would be thinking of the fellow with a thousand dollars. The people we are thinking of is a person of great wealth, who is not obscure. He is obvious, wherever he is.

MR. COYNE: When you suggest these are the people you are after, I understand your point. You are not suggesting that these are people who should be made liable to tax under the law, but only ones whose tax is sufficient?

MR. LITTLE: That is correct.

MR. COYNE: Would you see any significance of double taxation in this area. A Canadian resident in Florida who happens to have still his Canadian domicile, makes a gift of estate or shares in Florida to someone else in Florida. One might presume that either the State of Florida or the U.S.A. might have a tax on such a gift. It would be logical enough but as I think I take your suggestion, on the point of your Canadian domicile, he would also be liable to gift tax in Canada.

MR. LITTLE: That is a very fair point and there would have to be a relieving position, as there is on estate tax and income tax, to avoid double taxation.

MR. COYNE: Would there be any merit in limiting the effect of this tax on Canadian domicilaries, either to assets in Canada or to gifts made in Canada. Is that really what you are getting at -- the man who moves out of Canada to reside outside and who then makes gifts of his property that is back in Canada.

MR. LITTLE: I think you would have to have it more general.

MR. COYNE: Occasionally the opposite type might occur, of integration between gift taxes and estate taxes, that is, instead of basing both on domicile, they should both be based on residence. Would the committee have any views on that aspect of it? Perhaps your views would be against it, from what you said earlier, because of loopholes?

MR. TOWNSEND: There is a loophole we are thinking about as well. I think this is perhaps the answer to the question. In the United Kingdom, where I gather gift tax is on domicile, the man who comes to England, stays two years, is not domiciled in England, whose domicile remains in Canada, he can give away everything he has and escape gift tax in both countries.

MR. COYNE: Thank you, Mr. Townsend. Is this really a problem of significance? It seems artificial for a fellow to move away for a few years, to give away his property and then come back. Is this something you have in fact met up with, in specific cases, or is it rather a theoretical affair, that you know of what could be done?

MR. TOWNSEND: I have practical experience of

two people doing it.

MR. COYNE: Doing the same thing?

MR. TOWNSEND: Yes.

MR. COYNE: You comment on page 76. You make certain comments as to the exemptions, and amongst other things you point out that they may be anachronistic in the sense that they have been in the Act since 1935. You do not say anything anywhere about rates of gift tax. Did you give any thought as to whether or not the rates should be increased in view of the substantial increase in income tax rates and estate tax rates since 1935?

MR. McMACKIN: I do not think you could say that that is the position. I think you could say it would be better to leave a fairly wide margin between the incidence of gift tax and the incidence there would be of estate tax. If something is passing as a gift, it passes on the death instead -- because in this manner quite frankly, the people who have been opposed in principle to estate taxes -- I do not think they said this in so many words but the background is there -- take the attitude that the gift tax should be at a level to encourage rather than discourage gifts, while at the same time high enough that the taxpayer would be making a contribution to the revenue when he is making the gift.

Obviously if you put the rates up to something approximating the effective rate that the man would probably pay on his whole estate, you would certainly pretty well remove any motive for making gifts.

In that connection of course perhaps this is

meaningless now but it is interesting to realize that the gift tax was introduced as something related to the income tax, long before the federal government was in the estate tax business.

Another thing is that the gift tax, in many many cases, reaches the revenue a good many years sooner that the estate tax.

I think our feeling was, on such limited study as we put on it, that the present scale of rates is about reasonable and appropriate.

MR. COYNE: Thank you, Mr. McMackin.

Mr. Chairman, only for reasons of priority, and in view of the time, I would propose not to ask any further questions on gift tax or on administration, which is the immediately succeeding chapter, although useful questions may be asked. Perhaps you yourself have some.

THE CHAIRMAN: I think there are some questions on administration, but before administration I would go back on chapters which we have missed. Before doing so, I must inquire whether anyone here has any question on gift tax. If not, we will revert to the chapter on capital cost allowances and business losses.

Mr. Grant would like us to take estate taxes now, because he has a particular interest in estate taxes, so if you are ready we will move to estate taxes.

MR. COYNE: Yes. Chapter XVI, dealing with Estate Tax Act, is on page 84. Mr. Little, perhaps I might refer at the outset to your suggestion in paragraph 241. The suggestioln is actually marked (i),

that many Canadians liquidate their holdings to avoid forced sale at death. It is obvious that this is a widely held opinion, that the existence of death taxes alone causes the sale either before or after death of many family owned business, to Americans or to large companies. This is a view which has been urged on the Commission. However, perhaps one or two others have cropped up in the hearings, where there has been singularly little evidence presented to the Commission that death taxes, rather than other considerations related to the death, no doubt are the motivating factors in such sales. We have said this to others and I would suggest to you that it would be helpful in assessing this matter if specific evidence on this point were available. Would you comment?

MR. LITTLE: Yes. Here again one cannot indeed give names, but during the course of our deliberations on this subject, within the year in which we were working, I myself have had two clients of mine who closely knit independent corporations and had been independent for a great many years, and directly because of concern as to what would happen to the owner on his death, from the succession duty point of view; and in one case of a young owner, because of his concern about the other family members involved, and about the possibility of a forced sale of the business, he started to look about for a sale of a business, not that he wished to retire from that activity but simply to be bailed out from the investment, and in each of these two cases the companies were sold to American parent

companies and became wholly owned subsidiaries of a United States company. So far as Canada is concerned the company is still there and still operating and the working family members are still employed and to that extent there has been no change but nevertheless in our view we think that our economy looses something when this type of enterprise either goes abroad or goes into a group public control. We think there is something that is good and useful and vital about having a family owned business active in the country, rather than have it dominated from abroad or publicly owned in the country.

This is a terribly difficult thing to assess, whether it is a good thing or a bad thing. We think it is a bad thing, but we are convinced that this is a serious factor in influencing the sale.

MR. COYNE: One of the great difficulties in assessing this sort of matter is to distinguish between motivations. There is evidence that closely held companies are sold by the owner or by the estate following his death. The problem is to distinguish between the factor of death taxes as a motivation and other factors, such as dropping out of the management of the business, and other factors which would normally lead to some sales, even if there were no death taxes.

MR. LITTLE: That is true. It is difficult to sort out motivation factors but it is also true that every member of this committee spends every year a good deal of time on estate planning work and this is motivated by one consideration only in most cases, and

that is the duty that will have to be paid, and the reorganization of one's affairs, so that this problem can be met; and in the cases where private businesses are involved there is no question in our mind that this is a serious factor in motivating the decision of the owner.

MR. COYNE: Just picking that up for a moment, it rather leads into the suggestion No. (iv) at the foot of the page. You rather deplore the amount of time and effort which wealthier citizens devote to these problems of avoiding taxes. Is it not inevitable that high taxpayers will always spend time and effort trying to avoid taxes? Is there anything which makes estate tax unique or even particularly outstanding in this respect? If there were no estate tax, presumably there would be some other tax embodying a progressive principle to some extent. Then would not the same efforts continue and if you were not planning estates you would be planning something else.

MR. LITTLE: I hope so, Mr. Coyne.

MR. COYNE: What is the significance of the Estate Tax Act in this particular context, the time and effort that is devoted to minimizing it or avoiding it?

MR. McMACKIN: I think one thing in the committee's view is that it is such a very poor revenue producer, that when you balance all these various objections mentioned, including the plans, against the two facts, that it produces a revenue which is a very small amount of total national revenue and also that it produces a good deal of deaths amongst the class of

people who used to be the backbone of the country, the small medium-sized businessman, when you add that to the burden of his tax, the further burden like all of us here and some others who are in this room know, a good deal about estate planning, will agree that the burden of worry and effort and sometimes uncertainty and difficulty in finding a solution, that this sort of thing imposes on a man who ought to be a busy man, is quite a major factor in a good many cases, and also continues from time to time and over considerable periods of time.

We are not trying to suggest that the Estate Tax Act should be abolished, and certainly not on the ground of item (iv). We just mentioned as one of the undesirable things, but I do not think the same planning acts in the same way as regards income tax problems.

THE CHAIRMAN: I think I have heard this observation. I think you made a similar observation in regard to income tax. You refer to the waste of talent.

MR. McMACKIN: Excuse me, this is the same sort of thing also, although it is true that the tax is turned around to the taxpayer rather than if he employs. I think that is part of the thing we have to plan about once a week in the country. I would say that 25 per cent of the gross national product is taken out at levels of government for government purposes. It seems to me that if one is going to make an allocation as between individual businesses, all the way up, it will take a lot of revenue and a lot of turn. No matter how

simple the laws are, they can never be that simple that one takes a pair of scissors and cuts them. I agree we have to make them simple, but I do not think it is shocking if there is a great deal of talent wasted.

MR. LEACH: There is a possible answer to the question, what makes the estate tax different? A man is faced with a progressive rate of tax which may not move a great revenue but it has a maximum effect on him and he feels he may not collect it. All the time it makes a very severe problem for him to leave it.

COMMISSIONER PERRY: The only thing that increases your respect for $100 million is to try and find it some other way.

MR. LITTLE: Spend less.

A VOICE: Heresay!

MR. COYNE: I wonder if we could turn to your discussion on exemptions. I would like to ask one question. You recommend that there be an increase in the basic exemption, from $50,000.00 to $100,000.00. As I understand it, you support that recommendation simply on the basis that 16 years has passed and the value of money has dropped in half.

MR. LITTLE: Only in part. Perhaps we did not make it clear, but we were very conscious, in making the recommendation of a doubling of the estate, which produces the revenue.

MR. COYNE: I agree.

MR. LITTLE: There is a very large number of the estates under $100,000.00, which produce a tiny amount of the total revenue. We felt this made sense,

not only from the change in the value of the dollar but from the administrative point of view.

MR. COYNE: I take your point. Perhaps I might go as I was going and postulate this view. One can see why a small estate should not bear tax, if it is going to support a widow and children. Exemption based on circumstances can be supported on sound grounds of theory, but do the same considerations apply in any event, if say the estate goes to the deceased man's friend, to his mistress, or to a home for stray cats? Why a basic exemption of the magnitude of $100,000.00 regardless of the distribution of the estate and the person to whom it is to go?

MR. LITTLE: Once again, throughout all our deliberations we assumed that basically the tax exemptions are to raise revenue. We know there are some other circumstances, but we can see no point in taxing an estate of under $100,000.00. Administration is involved. There is not very much revenue gained on it. It does not bother us that the home for stray cats should receive $100,000.00.

MR. COYNE: If we might refer to your figures on page 84, you point out that of the $82,976,000.00 collected in 1960-61, only $6,440,000.00 came from the estates of less than $100,000.00. Superficially, one might assume that was the only revenue loss which would be suffered if your recommendation were adopted. We dealt with this when speaking to the trust companies, that this was a revenue loss which would be suffered if all estates of more than $100,000.00 paid their taxes

from $50,000.00 and up. Speaking from memory, the figures they gave of estates getting the full $400,000.00 exemption was substantially greater -- it ran to $20 million to $25 million, speaking from meory -- although it was a good deal more than double the figure you suggest. Perhaps I could just put it to you that the loss of $20 million out of $80 million is greater than this loss of $6 million out of $82 million.

MR. LITTLE: I would say that is right and it would have been preferable if we had made that point ourselves.

MR. COYNE: I think it is clear from the way you describe it.

MR. McMACKIN: Are we not misunderstanding something? Someone may correct me if I am wrong. On Item (i) on page 86, where we refer to the basic exemption for every estate, we simply mean no estate of less than $100,000.00 would be assessed at all.

MR. COYNE: Yes.

MR. McMACKIN: I am wondering if the trust companies were not looking at it as if every estate had an exemption of $100,000.00, then you would get $20 million, because you have to apply tax on $100,000.00.

MR. COYNE: I am sorry, I misunderstood. I understood that every estate would have a basic exemption of $100,000.00.

MR. McMACKIN: No, no.

THE CHAIRMAN: How would you tax an estate of $105,000.000?

MR. McMACKIN: On $5,000.00.

THE CHAIRMAN: So on every estate the first $100,000.00 would be exempt, not taken into account for tax purposes.

MR. McMACKIN: So you lose the tax on $50,000.00 on every estate.

COMMISSIONER PERRY: This is the sad experience, that exemptions of this sort usually cost more for the estates which remain dutiable, than those which it puts out of thepicture, than those who gain the exemption.

MR. McMACKIN: Actually -- I may be wrong -- if you have the exemption for widows and children which you have suggested, the $100,000.00 minimum only becomes important in the case of -- and this is to a smaller extent -- in the case of persons who leave no widow or widower or no children.

MR. COYNE: Except that the exemptions are cumulative, the man leaving a widow, if I understand you, has an exemption of $175,000.00, is that right?

MR. McMACKIN: No, no.

MR. COYNE: I beg your pardon.

MR. McMACKIN: You are just suggesting new exemptions and new minimums for your present exemptions and present minimums.

MR. COYNE: There are a number of different ways inwhich this can be done.

MR. LITTLE: Your point is proper, that it is not fair to look at the $6 million of revenue on 1,900 estates under $150,000.00 each. This is quite so. There are 1,400 estate over $100,000.00 each and if they

are exempt, that is $17 million, and if that is extended there is $20 million in losses. This was roughly the point I wanted to bring out.

THE CHAIRMAN: How much more have you on estate taxes? I think rather than interrupt this work we might go on to ten minutes past one or a quarter past one. If we have not finished then, we could come back to estate taxes. I speak of this because of time pressures. Would it suit you to go on for another 15 minutes and then come back?

MR. LITTLE: Yes, we would come back after lunch for the other one.

I assume there is no change in your plan, that those who have 5:00 o'clock plane reservations may retain them.

THE CHAIRMAN: There is no change, no alteration. I would propose that we come back with the shortest possible lunch hour, and stay until 3:30, to enable you to catch planes and to go away.

I think that will not permit us to examine excess taxes under this heading. I think we could do everything except that, up until 3:30. Then if you would like to discuss the excess tax that could be done on a subsequent occasion. I say that because I am assuming that there are some members of your committee really involved in excess tax and interested in it, but there are only a few of you really concerned.

MR. LITTLE: Two really.

THE CHAIRMAN: We could deal with these two later on, during our other hearings.

MR. LITTLE: That would perfectly acceptable.

THE CHAIRMAN: It would not involve much transportation.

MR. COYNE: Then I would ask one or two questions about the next recommendation. This has to do with the "special marital exemption". You say this would result in more equitable estate tax, particularly where there is quick succession. If I may say so, I gathered the philosophy behind this exemption is as follows:

> "In most cases the influence of a man's wife is an important factor in his success and his accumulation of wealth. The committee thinks it would be desirable to adopt a generous exemption privilege which would be available to the wife."

You relate it to the problem of quick succession and you suggest 50 per cent exemption, to the extent of the joint wealth of the two partners, with a limitation based upon the amount of the estate that goes to the widow.

I would like to put to you one or two examples in which conceivably there might be some discrimination that would arise out of the exemption provision which spreads so broadly, depending upon the particular circumstances of the taxpayer.

For example, and leaving aside the wife's separate assets for the purpose of illustration, a man

dies a $1 million estate. He has an elderly widow and three or four grown up children. The widow is in her late sixties. I think these are quite typical and normal situations. She dies a year or two later. As a matter of fact, as I see it, your recommendation in those circumstances would be that, in the first instance, the estate would have exemption of $500,000.00 based on the widow's exemption, and there being a quick succession and that the same property is there and the wife has no additional property, the balance of the estate, without further additional tax, would pass to the children, in their forties. On the other hand, you take a man in less fortunate circumstances, who dies leaving a young widow and three small children but with an estate of say $100,000.00. It is true that the estate pays no tax, but is there not potentially an element of unfairness or discrimination or arbitraryness, if you like, between the one person have a very large exemption regardless of circumstances and someone else having a very much smaller exemption?

Is there a problem in providing exemptions in any taxing act which are manifestly discriminating or covering such a broad range?

MR. LITTLE: Surely the real difference is that one person has $1 million and the other person has much less?

MR. COYNE: If he has $1 million, should he not only have a $100,000.00 exemption, like the little fellow? Why should he have $500,000.00 exemption?

THE CHAIRMAN: Why should he have any

exemption? Why should it not be 100 per cent?

MR. COYNE: We have been speaking in the past about equity, capacity to pay, lack of discrimination, neutrality, if you like, broadening the tax base.

Why propose some of these general notions that are advocated in other fields, why should you have such an enormous range of exemption in this estate tax?

Perhaps it is all summed up in your philosophy, Mr. Little, in the first sentence on page 86.

MR. LITTLE: I think that is true and also because it becomes an enormous range, if it becomes an enormous estate.

MR. COYNE: Estates will vary, but under our present system exemptions will not vary and the man with $200,000.00 has the same exemption as the man with a $2 million estate.

MR. LITTLE: We are really concerned about the point that if the estate goes to the widow, it is taxed when she dies.

MR. COYNE: Not if there is quick succession.

MR. LITTLE: Presumably one would not adhere to present quick succession rules and adopt that as a privilege.

MR. COYNE: You are proposing an even more quick succession rule. It pontificates that at the end of the five years, the second person on the same property could pay no tax.

MR. LITTLE: This is an amendment to the present succession rates, presumably it would not make that change if you adopted this.

MR. COYNE: In other words, you would say the need for quick succession provisions would disappear if this present marital provision were adopted.

MR. LITTLE: It would be quite wrong to pass from the husband to the wife free. This would not happen and is not intended to happen.

MR. COYNE: Let me ask you a couple of small questions on this point. It appears to have some relevance to this subsection, where you recommend special exemptions. Do you draw a definition between long mariages and recent marriages? Take the case of a man aged; 65, who has lived with his wife for 40 years. She has helped him to accumulate all this wealth, and you say on that basis there is a 50 per cent widow's exemption. What about the widower who at age 65 marries his secretary and dies the next year. Is she to have the benefit of the same exemption?

MR. LITTLE: You bet!

MR. COYNE: It may be a little facetious, but it does not seem true that the philosophy should be of that nature.

THE CHAIRMAN: You surprise your own committee.

MR. COYNE: You would not draw a distinction based on the circumstances of the deceased?

MR. LITTLE: I do not see how you could properly do so.

MR. COYNE: There is just one question, if I might turn to page 88 where you deal rather briefly with the question of an "annual wealth tax". This I suppose could replace both the estate tax and the gift tax?

MR. LITTLE: Yes.

MR. COYNE: You comment on the experience in certain countries, particularly Sweden, and then you point out that in Sweden there is a fully integrated method of administering such a tax for the benefit of different levels of government. Then you say:

> "It would appear that some such integration would be required for the efficient administration of this sort of tax in Canada. In view of the substantial autonomy of our three levels of government, particularly in determining the basis upon which tax revenues are raised, it would seem that such administrative integration would not be a practical possibility in this country".

I wonder if you would comment briefly on that statement, having in mind two things -- in the first place, as far as personal income tax is concerned, there is indeed a large amount of federal provincial integration and, as is true in the case of corporation income tax for eight of the ten provinces. Why do you regard it as being so utterly impracticable in the case of one tax?

MR. LITTLE: There is not really sufficient integration now as between the federal government and the provinces. It always appeared to us a difficult area. There is not as much cooperation as there should be. That past experience leads us to suggest that is not

a practical possibility. I would be glad of some help here. Mr. Lachance propounded the wealth tax; perhaps he would speak to it.

MR. LACHANCE: I think, Mr. Little, you have stated it. We think the Province of Quebec, is guarding its sources of revenue very carefully, and Ontario to some extent, and this would be a major shift in form of taxes.

Those two large provinces are in the death duty field and will have to be convinced of the merit of the wealth tax. It just seems like too big a job.

MR. LITTLE: As is also the job of compliance.

MR. COYNE: What you have just said is that you have a feeling this could not be arranged in this country in any event. That leads me to ask what is the difference in this respect between a wealth tax in which you emphasize this inter-government difficulty, and a retail sales tax where your major recommendation is premised precisely on an integration, as I understand it between federal and provincial governments. In other words, in a later chapter you do recommend that the federal government move from manufacturers level to retail level, on the premise that a single integrated tax between federal government and the provinces can be developed, and in which event you would extend the ambit of the tax to services which certainly will extend administrative problems and that sort of thing.

My sole point is that if you consider integration possible in the field of sales tax, and if it in fact exists in nine provinces, in personal income

tax, and in eight provinces in corporation income tax, why is such an insurmountable hurdle in the other two?

MR. LITTLE: I suppose there is the difficulty of bringing in the municipal form of government in the evaluation of property.

MR. LEACH: My recollection is that scheme had a particular advantage, because being integrated between municipal and federal government, there are local tax offices in various towns who are concerned with municipal taxation and they are right on the spot and they are in an easy position to administer a wealth tax. I think there is a sharp definition between that and the sales tax.

THE CHAIRMAN: Sweden has something like 12,000 tax appeals a year, under the wealth taxes. Sweden governs like one of our provinces, from that point of view. The municipalities are the creatures.

I do not think we need pursue this line of inquiry. The only criticism was that it appeared to limit this wealth tax to one consideration, which may be questionable.

MR. LITTLE: That is an error on our part. We should not have presented it in such a fashion, as though we dismissed it because of the impracticalities of administering it, but we should have dismissed it per se.

MR. COYNE: There were other factors behind your decision against the introduction of the wealth tax?

MR. LITTLE: Much stronger ones.

MR. COYNE: I will not pursue that.

THE CHAIRMAN: We have looked at it and are

looking at wealth taxes. Have you finished, Mr. Coyne?

MR. COYNE: Yes.

THE CHAIRMAN: I think we will reserve our questions until after lunch.

COMMISSIONER GRANT: I do not think I have any questions.

THE CHAIRMAN: Then we will stand over until after lunch. I suggest that we try to start sharp at 2:30 p.m. That means we all get back and be in our seats by 2:25, which will leave us just one hour in which we can dispose of everything, except the sales tax. Does that meet with the approval of you gentlemen?

MR. LITTLE: Yes.

---Luncheon adjournment.

---On resuming at 2:30 o'clock p.m.

THE CHAIRMAN: Gentlemen, I have never had my wishes respected so much before. I should like to think it was my influence, but I think the airplane plans have been an influence. If we are all here, I may say we were at the estate taxes. Mr. Coyne has finished his examination and he may have one or two questions left.

MR. LITTLE: And Mr. Chairman, at the appropriate time, we have a statement we would like to make on estate taxes.

THE CHAIRMAN: Perhaps your statement will take care of our questions.

MR. LITTLE: It is my fault, because I allowed our presentation to go off the rails this morning, in respect of this basic exemption. The intention was as follows. The basic intention was that it would operate in the same fashion as the $50,000.00 exemption, but it would not be a deterrent, but would be at a point at which the estate duty would comment to operate, so that you would be in a logical position. An estate of $300,000.00 obviously would not be the same as one of the $3,000.00. This means that revenue loss is not in at the minimum that we computed this morning.

MR. COYNE: Something like six?

MR. LITTLE: That is right, which would flow if this were the exemption.

MR. COYNE: Some estates would still pay the same tax that they do now?

MR. LITTLE: Exactly.

COMMISSIONER PERRY: There is $75,000.00 deducted now. Is that comparable to the present $40,000.00 or $60,000.000?

MR. COYNE: This was exactly the question I was going to raise. I have a further question, if I might put it. It is on a matter of detail. Really, the $75,000.00 exemption or deduction for the widow would replace the $60,000.00 one. Do I take it that in other cases where the deduction is now $40,000.00, you are not making any recommendation to change that.

MR. McMACKIN: We have said no.

MR. COYNE: At the present time it is $40,000.00 in any case, and $60,000.00 where a widow is left. I interpret what you have just said as being that you are proposing that the $60,000.00 go to $75,000.00, but you are not proposing any change in the $40,000.00.

MR. McMACKIN: That is right.

MR. COYNE: Then I take your proposals with regard to the childrens exemptions as being quite clear.

MR. McMACKIN: There is one point that goes with that and may have some little bearing on the incidence of the revenue. I refer to our recommendation that personal exemptions in no case would exceed the amount actually passing to the beneficiary in respect of whom they were granted.

MR. COYNE: I appreciate that is your point No. (iii) in the recommendation, that is a change in the existing situation. It rather reduces the conception of succession duty. There is one final point.

I wonder if you have made any attempt to calculate the effect on the revenue of your recommendation under the "Special Marital Exemption". Have you made any estimate at all?

MR. LITTLE: No.

MR. COYNE: Presumably it could have quite a considerable effect in view of the magnitude that it might reach.

THE CHAIRMAN: We note your suggestions with regard to an alternative valuation date. It seems like a fair suggestion. We have heard it before. I think I should point out that you state that a number of European countries have adopted a wealth tax.

I was inclined to think that where a wealth tax was in existence they went back a very long time and that they were not necessarily there at the same time as estate tax. There are some countries where there is both an estate tax and a wealth tax. I cannot say that all have both, but I can say that some do. They are not necessarily alternatives.

There is nothing more under estate taxes.

We will turn to page 34, capital cost allowances.

In the first paragraph, paragraph No. 101, in the last line, you say:

"The taxpayer may claim less,
but not more than this amount".

Capital cost allowances are a technical problem for the prescription governing appreciation and I think there only difference from depreciation is a matter of

measurement and not of purpose.

It seems to me that they serve the same purpose. That being so, it has always been felt that the depreciation is a cost of the ammortization of some asset in a man throughout his life, and it is a cost which has occurred whether there is a profit or loss, whether it is exempt from tax or taxable, it is in fact a cost.

Now why, when we come to capital cost allowances, should we change that and say that it is something which one may claim less than, or not claim at all, or defer? You have all these things I think referred to here. Where I am worried is in regard to losses, which is one thing, where you suggest it might hold up the thing.

Under the three year exemption for amounts it is exporting, not all claim capital cost allowances, but holdthem over until there are ultimate profits. If one is exempting three years of income from tax, surely we ought to measure income and not something else? Why should we not require all taxpayers to take the full amount of capital cost allowances into the year to which it pertains under our tax system?

MR. LITTLE: Certainly there are very strong arguments that one could put forward in that direction, Mr. Chairman. I do not think that we really considered the problem in that particular point of view. So we have not a committee view to express. I would be glad of some help from some of my assistants at this point.

THE CHAIRMAN: You are the best people in Canada

to ask about it. It struck me with some force the other day, in the question of the mining industry, the extending of the three years to five, six or seven years in the industry, and saying you must measure income from there.

MR. McMACKIN: I think it is the opinion of many accountants that there are many aspects in certain classes of assets. This happens quite frequently. You get a situation where there is a maximum allowance on certain types of assets in the early years and it may greatly exceed what you feel is a sensible estimate of the depreciation actually sustained.

I have no settled views on the matter. As Mr. Little says, we have not discussed it. Also we may at other times get the reverse situation. If you are going to talk of depreciation as the cost, as of course it is, I find it hard to think you can measure up what happens by capital cost allowances under regulations. It is often appropriate, but often not.

The depreciation was reduced to one-half. That was under the old system.

THE CHAIRMAN: The result of that decision is what I am putting to you now, I suppose; and of course modified by your reply.

MR. McMACKIN: Would it be bad if the loss carry forward and loss carry back provisions were extended sufficiently in most cases, so that there would not be a tax on an undeserved loss?

MR. LITTLE: This goes back to what we refer to, the determination of income in accordance with

earnings.

We as a profession would qualify the statement, if depreciation were not claimed here, unless in respect perhaps of very old assets, where it did not matter. In the normal course, we do take the stand as a profession that this is a cost which must be taken into account, and I was to give a qualified expression of opinion if the taxpayer fails to do so, I must say this is a very strong argument, in the direction you are taking.

THE CHAIRMAN: In order to measure income, it is certainly necessary to refer to depreciation. I say, as a matter of grave concern, and I do not know where the answer lies. I think anything short of depreciation must be concession, and if it is a concession it must go to industries which have not used capital. It may be a good and useful concession -- that is something I do not know -- but I think we ought to call things by the right name and if it is a concession let us label it a concession.

MR. LITTLE: The freedom in regard to the claim is a concession.

MR. TOWNSEND: In our suggestion on page 36 it seems we are going part of the way towards meeting this. We are suggesting that the difference between the maximum capital cost allowance and the amount actually claimed be available for carry forward in future years, but should be taken in subsequent years to the extent any taxable income is there. So this does force the taxpayer to take the capital cost allowance if he has any

taxable income.

THE CHAIRMAN: You are going part of the way, are you not?

MR. TOWNSEND: Yes.

THE CHAIRMAN: But when you relate it to any taxable income, that is my quarrel.

MR. TOWNSEND: We were of the feeling regarding capital cost allowance that we should be certain that he gets it at some time as an allowance against income and the loss carry forward provisions go part of the way.

THE CHAIRMAN: I do not think we should be concerned with whether we get it against income or not but should be concerned with whether you draw off as cost, if he happens to have income as part of his cost.

MR. TOWNSEND: I agree with your point on the mining question. There seems to be something wrong in not taking the capital cost allowance in the three years existence. It seems to me the same thing in the mining industry as far as losses are concerned, which fall into the three year exemption. In fact, I think you can get into the situation where you can carry forward a loss from the three year exemption period without applying it to income earned in other years than the three year period. It is a similar type of product.

THE CHAIRMAN: It is interesting to have comment with regard to your discussions on current value rather than actual cost, and to note that in one country, Holland, they relate their taxable income, or measure their taxable income having regard to good accounting practices. Yet they do not allow current assets

depreciation of fixed assets as a charge and even in spite of the fact that accounting practice in Holland permits them. I presume they must have legislation against them, to keep it out.

You made your point with regard to terminal losses and I wonder whether this is a valid point.

I can quite see how it can occur that the cost may be going up instead of declining, because the capital cost allowance has been inadequate. But are there cases where costs have actually increased so that this condition would result, if you refer to the bottom of page 37.

MR. LITTLE: Yes, ordinarily it results from the fact that some or the major portion of the class of assets are disposed of for some reason or another before they are entirely written down, with the result that the unammortized portion of the depressed asset remains in as part of the cost of the price of the asset.

There is an area of abuse as you no doubt well know, Mr. Chairman, here; that once again using this as a technique for extending and prolonging the period over which capital cost may be claimed.

I have seen this operate in a company in perhaps the same fashion as buying loss positions, buying a company which had a very large terminal loss in its fixed asset account, but these were not required to be brought into income calculation, because there was a fixed asset in the year and one is inclined to leave the asset, or the structure or the shed or the property, so as not to dispose of it and then some other person

can acquire the corporation with this terminal loss available and take it in at any time; but at the time he disposes of the remaining asset or spread it over future years. I am sure all of us have seen this particular technique adopted and it seems unfortunate that it should be available, because it simply destroys part of the revenue and the rest of us have to make up for it.

THE CHAIRMAN: Could that be overcome by introducing the word "substantial" -- assets substantially disposed of.

MR. LITTLE: Perhaps I should ask Mr. Garneau to say something on that, because it is his special line.

MR. GARNEAU: No, I do not think I have anything to add, Mr. Little.

MR. TOWNSEND: On this point, our suggestion is that this must be merely a permissive. The suggestion in our brief is that this be permissive, if required. Mr. Little was speaking about the position which would be such that a person would be forced to make the claim. Our suggestion is that a person be allowed to make it, if he wishes.

THE CHAIRMAN: My mind is thinking of the need for the Department being able to assert it, that the case has been disposed of, even allowing one small asset to be there, and I would think there need be some word inserted in the Act to enable them to do it, or perhaps a whole phrase or subsection.

Is there anything further on capital cost

allowances? If not, I think we understand this very well. It seems to me it is clear, and I was surprised at the number of items that you have been able to list, where the rates were inadequate. There is the idea that the rates pick up most things. You have succeeded in listing six different classes of items here. It may well be, I can assure you, that our studies will look into this. Then we will move on to "business losses". Mr. Coyne, will you pick up anything that I leave out?

MR. COYNE: Yes, I will, Mr. Chairman.

THE CHAIRMAN: The first thing you refer to is the extention of the carry-back period, and you go three years back, but you do that having regard to the practice of accountants and others. But you make your point with regard to it. I of course, as I have read this, wondered whether this would not slow up assessing and cause uncertainty as to assessing practice, beyond what uncertainty there may be at the present time.

I do not think the refunds are a matter of concern. The economists tell us that it is a good idea to have refunds, and they say there have been increasing government deficits under certain circumstances and that it is a good thing to have. Do you think it would cause administrative difficulties?

MR. LITTLE: I do not think it would cause serious administrative difficulties. To be quite correct of course it would not of necessity have an effect on the assessing procedure, to know how you really can be considered closed, until a few years have elapsed.

MR. GARNEAU: Except possibly if we add something to the effect that upon reassessment the only points to be considered would be the loss that is brought in all of a sudden. You might have quite a proper assessment previously, but should we, on the occasion of a subsequent loss, reopen even beyond the four year period, and at that time allow the taxpayer to appeal the assessment and bring in something else that he forgot to bring in previously.

THE CHAIRMAN: The scheme of the law indeed is that it is not the loss year that is being assessed by the profit year and if you carry-back you open up the years of profit.

MR. GARNEAU: But you might have restrictions on the points that you reopen, could you not?

THE CHAIRMAN: I suppose anything could be written into the law.

MR. GARNEAU: Of course other features are suggested, like the deferred excise depreciation and matters of that sort. These would have to be brought in, if we deferred, we have a carry over of excess depreciation and that would have to be taken into account also, but apart from the few items like that, you could cut it out.

THE CHAIRMAN: You have loss years, or had a loss year and wish to carry it back against profits, you would not necessarily need to adjust the profitable years for capital cost allowances, would you? In fact, you said it would be closed off for a loss.

MR. GARNEAU: Yes, I think so, except for the

carry back provision. If you say the government adopts our scheme of setting up as a separate class the excise cost allowance that we are not claiming, and if as we have suggested here we have to take it in the first year when it becomes available, you will have to go over these figures again in the case of a year of loss.

MR. COYNE: It was just the thought here, the situation that Mr. Garneau was thinking of, I presume is where you have already had a loss and are carrying forward a sum of depreciation, which you have then used up in a subsequent year and at a later stage it turns out to have been a nil income year. Therefore you are entitled to carry forward that capital cost allowance under your scheme into another year?

MR. GARNEAU: Yes.

MR. COYNE: And this might open up in that respect one to three back years.

MR. GARNEAU: That is right.

THE CHAIRMAN: Moving on then to "Farming Losses" you would really eliminate personal expenses, depending on the allowance of personal and living expenses. The law now limits the hobby farmer, or the one whose income from other sources is greater than the farming, to $5,000.00. Mr. Little, I wonder if that is not too great a boon to our friends who take their recreation by way of farms rather than by golf or other things. I can quite see the losses jumping up to a pretty large figure.

MR. LITTLE: We had hopefully expected that a

strict approach to what is properly deductible might cure the situation. We quite agree that there is no real basic sense in allowing a certain class of taxpayer to have this expensive hobby when others are not allowed to do so.

On the other hand, it has operated in certain circumstances, we think, to produce some hardship where in fact the real farming operation is going on. It seemed to us that both acting as hardship to indigent farming operations, it has opened the door to expenses where there is a real hobby farm.

THE CHAIRMAN: You are the first one to bring to our attention the hardship resulting from this restriction, the hardship being those people who are real professional farmers and are open to grave losses. Do you know of your own personal knowledge of any instances of hardship?

MR. LITTLE: Yes. I do not know about the committee but my experience has been the other way.

MR. PHILIP: I have. I have seen a farmer who had an investment income from an estate and who was in a position to deduct farming losses.

THE CHAIRMAN: Does that result in hardship? If he had got that much investment income, he can close the farm and live on his investment.

MR. PHILIP: That is possible.

THE CHAIRMAN: Where does hardship begin and end, then?

MR. PHILIP: That is the question.

THE CHAIRMAN: I should not like to open this

up, because of the instances you recite, the case of men with an investment and a $5,000.00 limit. I would say that a man would have a hard time.

MR. GARNEAU: I think of a building contractor who bought a farm with the hope of tying both ends, but did not succeed. He cannot really sell the farm and get his money back, for one thing, so he continues operating, losing money every year. He is actually a farmer, of sorts.

THE CHAIRMAN: He is not losing as a building contractor?

MR. GARNEAU: He raises pigs but he cannot make money out of it, but it is a real farming operation.

THE CHAIRMAN: I think we have the measure of it.

MR. COYNE: I wonder if the difficulty which the committee see arises not from the difficulty of section 13 as such but from the words used in the section, "source of income from either tax year is neither farming nor a combination of farming --". Surely it is those words, that collocation of words that prevents that deductible of what you consider as farming losses.

MR. GARNEAU: Yes, that is right.

MR. COYNE: If the wording were changed, the section could be preserved for its original purpose and yet perhaps eliminate the difficulties you are mentioning.

THE CHAIRMAN: Going on to consolidated returns, I was surprised to find this. My own experience matches this, I must say. I found in every situation where I thought we need consolidated returns had been cured by

some other device, some other means of arranging matters; but these means have all been done for tax purposes, following the natural or the logical forms.

In a questionnaire which was put before us by the Vancouver Board of Trade they indicated that something like 37 per cent of the replies to their questionnaire stated that more taxes had been paid because of the inability to consolidate, than would have been paid if they could have consolidated.

MR. LITTLE: I find that very surprising.

THE CHAIRMAN: I found it surprising at the time and it did not match my own experience, but my experience was a small one and I was prepared to accept it. I am glad your people are not able to join with the Vancouver Board of Trade and say that a lot of people are paying more taxes because of lack of consolidated returns.

MR. LITTLE: I would not have thought it, but Mr. Kelsey is from British Columbia and may think differently.

MR. KELSEY: This puzzled some of us. I was on a committee associated with that study and this was merely a tabulation of answers from the business community. It did puzzle one.

THE CHAIRMAN: It left me still puzzled.

MR. KELSEY: It puzzles us, sir.

MR. McMACKIN: There are some situations. I had one where the merger is not available because the companies are incorporated in different jurisdictions and the personal apportionment of the assets is not a

satisfactory solution, for a number of reasons.

THE CHAIRMAN: I am sure there must be.

MR. McMACKIN: I should say I think they are exceptional, but there are probably a good number of cases across Canada.

THE CHAIRMAN: You may recall that the right to consolidate was withdrawn. There was no public outcry then at all. I was surprised that was the fact. Since there was no great demand that I have heard of, and from what you say, I think it confirms the general situation, other than the one illustration that I can bring to mind.

Is there anything else on consolidation?

MR. COYNE: No, Mr. Chairman.

THE CHAIRMAN: Then I presume you are formally against "trading in loss companies". We find people come down on both sides of this. The economist can see a good deal of merit in trading in loss companies, where the merit comes about because if one can recoup part of his losses it is an incentive for his venture. Why are you against trading in losses?

MR. LITTLE: In the situation that we see, Mr. Chairman, this is an uneconomic performance, we believe. It is simply someone now generating a profit which ought to be taxed and he seeks some method of providing a shelter on it. It has no purpose at all. I can agree that an economic argument might be for a group of shareholders who venture into a business and find this is losing money, to take the opportunity to carry that loss over forward against some other business

venture that they may be able to turn to as an incentive to that group of people to stay in business and be productive. But this is quite different in allowing somebody else in a private business to come in and assume the shoes and carry forward the business.

COMMISSIONER PERRY: I think they go a little further and suggest that the enterprises which have incurred the losses, by carrying in, may enable a local person to start the business and start in again in another industry.

MR. LITTLE: But they give no assessment as to what one normally pays for a loss business.

COMMISSIONER PERRY: I am roughly familiar with the revenue. This arises from a short discussion. The feeling was that if this thing were more in the open, the market price of loss companies would go up, that this would become more of a competitive bidding process and simply because it is not in the open now, people can get away with paying as little as they do.

THE CHAIRMAN: I suppose there are reasons inherrent now in the purchase of loss companies which depreciate the value of the losses.

MR. LITTLE: It can be more difficult.

COMMISSIONER PERRY: Please do not think that we are doing any more than trying out an idea.

THE CHAIRMAN: I did want to get your firm answer on that. I think you have given it fairly clearly. If any of your members are here, I think they should say so, because it is a highly controversial subject and I presume that you are speaking here really

your own view, or are you speaking for the whole committee?

MR. GARNEAU: There is an argument the other way, that since the government takes a good deal of the profit it should also suffer the same proportion of the losses when they occur. There would not be much of an argument for stopping an individual from selling a company and recouping it in this way.

THE CHAIRMAN: There is a partnership argument. If you pay the government half of the profits, the government will make out a cheque for losses and give you half the losses?

MR. GARNEAU: It is logical.

THE CHAIRMAN: I am not sure it is logical, but it is an argument.

MR. TOWNSEND: The argument that can be made against trading in loss companies is going back to our general philosophy that the corporation, on the part of business, should not be treated any different for tax purposes than an unincorporated business. If it is made possible to sell loss companies, then the poor individual who has an unincorporated business and who has suffered loss is not in a position where he can sell his loss, presumably. I do not know how one could develop legislation to allow him to sell his particular loss.

THE CHAIRMAN: I suppose there is something to what you say, that despite what you say about the desirability of making all business corporate, and pay the same taxes, it can hardly be accomplished unless

all business is carried on in the same form. The corporate form is different, there are certain disadvantages and disparities which arise because of this.

MR. LEACH: The loss trader could take in a partner.

THE CHAIRMAN: He always could. He could make it completely analogous to a company.

MR. TOWNSEND: As we mentioned in the last paragraph on page 44 we are not satisfied that the new plan, section 25a, eliminates the disability on selling loss companies.

THE CHAIRMAN: Thank you very much for the comments on that. We certainly will have a very close regard to the technical aspects of it, and you have made a suggestion as to how to do it, as to how it will improve the section and tighten it up. Is there anything else with regard to farm administration?

COMMISSIONER PERRY: No.

THE CHAIRMAN: We move now to page 78, "administration". That will be the last chapter we will deal with. You get in right away to a very important area of discussion. You say they seem to have little time or opportunity for study of the tax laws with a view to recommending improved legislation in the light of changing conditions. You suggest also there should be an opportunity to bring in other people on certain matters. You say that advanced publicity should be given to any proposed tax change, when secrecy is not essential. I wonder if you have thought of any criteria as to when secrecy was essential and when it

was not essential. One could think of obvious cases in both categories.

MR. LITTLE: Yes, I should think that as a case of extention of sales tax to an area that was not previously taxed, that any advance information of that would result in a great deal of buying and selling which would not otherwise take place, by people trying to escape the tax.

On the other hand I would suppose that, as in the United States, it might be very useful if there were good vigorous public discussion about the scale of rates of taxation. I think these two examples typify the sort of thing we had in mind.

THE CHAIRMAN: The scale of rates I found a little difficult. The companies might guess how they would be affected by a change in rates and guess at changes in rates they might permit speculation in change in capital values. People would gain and people would lose as a result of whatever information was made available.

The technical aspect of such a thing, I would not have thought anyone could make a profit or a loss very readily out of it.

MR. LITTLE: I agree.

MR. McMACKIN: Was there not also a large area relating to purely technical amendments in these appendicies, loopholes and so on. There were matters relating to minor amendments of the Act which may not be very important in the overall picture but are often badly in need of amendment in order to prevent occasional

and unnecessary injustice.

THE CHAIRMAN: I would like to ask you as to what kind of a pre-budget discussion should be had by officials with the public, and then I would like to ask you what kind of post-budget discussion might be had.

MR. LITTLE: That would depend upon the budget, I think.

THE CHAIRMAN: Before the budget one of course can discuss to advantage all areas, whereas after it the government is committed to certain policies and one is restricted in discussion, except in rare circumstances, to the technicalities which will result from implementation of that policy. Would you have in any way a public discussion before the budget? I do not think you propose that. You propose a group which would work with people outside the government and on those things which were in secret, it would be able to seek advice and guidance, for the good of the community. Would it do that privately or hold public hearings?

MR. LITTLE: I think we envisage this as being done privately.

THE CHAIRMAN: I think I can anticipate problems arising if it is done behind locked doors. One person in the community wishes to know what is being said about the laws by somebody else, whose views are diametrically opposed, or expected to be. Would it not only be fair that it be exposed.

MR. LITTLE: I suppose it would, although it might have some effect on one's readiness to come and speak, if one realized one were speaking publicly.

THE CHAIRMAN: I have not noticed you people being very retiscent today, and is not this the kind of position you would have.

MR. LITTLE: One might take a particular industry, say a group of distillers, who would be perfectly willing to talk privately to the Department of Revenue and Finance about their own problems, but who for public relation reasons would be very reluctant to appear to be grinding their own axe. I think this was the group position in regard to the American group a week ago.

THE CHAIRMAN: Perhaps there should be facilities for both. This group of people would be people from the departments named, who would in the case of public hearings sit somewhat the way we are doing now and listen to whomsoever wants to come and make a pitch.

MR. LITTLE: I should think so.

THE CHAIRMAN: If they wish to go on to the questions with regard to that area which should be done in secret, they might do so at the same time. That is a sound project. I think so. Then, on post-budget, what you are proposing there would not be very much different from what it is now. Right now you have a joint committee of the Bar and the accountants meeting with the appropriate officers who discuss the bills, and this is what you would propose here, I think.

MR. LITTLE: Yes. I think that if there was a group, and it need not be a very large number involved, some group whose serious responsibility is the continuing review, such responsibility of making

recommendations for example to a Minister, we think that group would be in a different position for example from say the Deputy Minister of National Revenue. We think that the function would be a little different.

THE CHAIRMAN: Would the group be within one of the Departments, within the government, would it be a Commission or a department of government.

MR. LITTLE: We thought of it as a group within a Department and our choice would I think be the Department of Finance unless it were a joint committee of the two, but it would be permanently employed.

THE CHAIRMAN: Then you speak about people outside of the Department being brought in, do you not?

MR. McMACKIN: Yes, at the bottom of page 78.

THE CHAIRMAN: So that it would be a group appointed by a Department and each for this purpose might bring in people as consultants who were not regular members of the Department. I think I understand that all right.

MR. COYNE: Are you not talking, Mr. Little, about two separate groups here? On page 78 you seem to be speaking about a group in the second paragraph, of civil servants; and in the third paragraph it seemed to me as though you were speaking of a different group.

MR. LITTLE: I think we were, but it could easily go from an extension of the permanent group, for this particular purpose.

COMMISSIONER PERRY: It would be a little more inoperative to set up a group within a Department which would receive recommendations from the government, if they

are civil servants themselves.

MR. TOWNSEND: The joint committee of the Bar Association and the Insitute are under severe time pressumre and they make their representations, because I think it is usual that the first reading and the legislation arising from the budget has been a very clear indication of the problems that arise in legislation going through without a proper review. I think we were discussing this morning the 25 per cent Canadian ownership. Whether one agrees with the policy or not, we should surely expect that the legislation as such, puts into effect the policy decision of the government, and the section has not done that.

THE CHAIRMAN: When should one get at that? Once the Bill appears?

MR. TOWNSEND: I think if the Bill could appear on first reading, with a clear understanding that there would be a period of time before it would be taken any further -- during which time a study could take place, I think this would be satisfactory. But if it is merely going to be a day or so delay period between first reading and second reading, and so on, then this is not sufficient for people such as ours to study the Bill and come forward with sensible suggestions.

THE CHAIRMAN: I think that is extremely helpful. We are looking for help in this area because we have heard about the need to do something of this kind. I must say I am impressed as a result of this job, with the salutory or the filtering effect perhaps of public hearings. I wonder if there is not some way

to make public hearings operate for this purpose, and I think perhaps there is.

Now, you speak about advance rulings. I was rather surprised to see you come down on that, in the middle of page 79, where you say:

> "That provision should be made for a taxpayer to obtain prompt advance rulings that would be binding on the government, based on the facts as presented".

That of course is a very radical departure from what we now have. If we are going to have government committees dealing with matters which are binding, it is tantamount to assessment in advance; and if it is assessment in advance I think it is much worse than assessment afterwards.

Sweden has recently brought in a system of advance rulings and it has a board to deal with it. They deal with 200 or 300 advance rulings a year and these go into several thousand. The reason that it is slow and moderately expensive, but essentially a slow thing. Two or three months is the minimum, I think to secure an advance ruling.

I do not know if that kind of action is going to do anybody much good. It is a matter of clearing things for business transactions. It has to work fairly quickly.

Once you have a procedure of this kind with this formality, I think we may accept the fact that the assessors are not going to be as helpful as they are now.

They will say it is a procedure and you can go with the procedure.

The United Kingdom has never adopted the general system of advance rulings, although there are three or four places in their Act where you can secure and find an advance ruling, but they are in specific parts, there is no general provision. In fact they seem to say the same things which one requires to say, that they will not deal with hypothetical cases by giving advance rulings. Actually of course if they do, they write the same sort of opinion later on, that one gets out of a Canadian department.

I take it you have considered all this and you feel it important that in order that Canadian taxpayers have the necessary degree of certainty, there shall be a binding advance ruling where the Department, providing the facts are unchanged, shall be permitted to give it.

MR. LITTLE: That is right, that is certainly the conclusion we reached. It is of course only fair to admit that we reached this conclusion in the light of the great amount of the uncertainty that the taxpayers in Canada have faced in the past, and if there was a good deal of simplifcation and clarification of the income tax law in Canada, this point would lose a great deal of its force and effect. In fact, it might not be really needed as seriously as at the moment.

I think it is fair to say we cannot help being pressed with the problems that now face us and if it would advance production by ten years, it will be

very helpful.

THE CHAIRMAN: There are two reasons you give to support this and perhaps I have covered both of them. One is that you are not satisfied with informal opinions from a Department because they are not binding, because the Department does not always stay with the particular situation. The other is that you cannot informal rulings, because the Department would be busy with other things. Can you tell me which of these reasons has brought you to this conclusion?

MR. LITTLE: Both.

THE CHAIRMAN: The first one is that I presume has a significance, that the lack of a binding commitment may be unsatisfactory to the practitioner.

MR. LITTLE: I guess so.

THE CHAIRMAN: The second one could be solved under our present system, I would think. The first one cannot be.

MR. LITTLE: Yes, one has to speed it up.

MR. McMACKIN: I would suggest that another reason which justifies this recommendation, the reason behind it, that wherever there is an extension of ministerial discussion, there immediately arises a field of great uncertainty. Also, there are areas in the Act where the honest taxpayer, who has no wish to do anything but what is right and proper, finds himself in a position such as for instance in the purchase of property shareholders in a company, he can find himself in the position where either he pays more than the market value and creates the unnecessary recapture of

depreciation for the company, or he pays too little, and he is accused of having an advantage conferred on him by his company, as the market value has always been a matter of opinion and varies very considerably, I think that is a good example, where as long as provisions of that kind are in the Act there is a great deal of difficulty in knowing somewhere to go to find out in advance.

THE CHAIRMAN: I think we can all find the tremendous need to be able to find out in advance. I would suggest that in all of these cases where ministerial discretion arises, there was provision for advance rulings, then in very many provisions for ministerial discretion in the Act, they might give some direction towards meeting this point.

In the United Kingdom Act, under the super-structure provision, there is the right to secure an advance ruling, because there is discretion, and in effect with an advance ruling it may be that there is a middle course which will secure it and will not tie up the administration, so as to slow up what you are doing and to cause you difficulty. One may easily get into that sort of difficulty and not be able to get any informal rulings and not be able to secure informal rulings at the end of six months. That would be a very serious result.

MR. LITTLE: I quite agree.

THE CHAIRMAN: All the rest of the points are extremely valid and we are interested in them. I think I can understand everything else in "administration".

MR. COYNE: Have you anything else on administration. If so, you have three minutes.

MR. LITTLE: And no time for us to reply.

COMMISSIONER PERRY: You had better take the three minutes.

MR. COYNE: There is one small point which I will dispose of in 60 seconds. There is a simple question on page 80 under the heading of Waiver Notes and Reassessment. You suggest that the taxpayer should have the right to withdraw one of these waivers on 90 days notice. I wonder whether you considered an alternative, the possibility of filing a qualified waiver of some kind, in other words, instead of going through the procedure of general waiver and then withdrawal, perhaps to permit the use of a waiver which would be qualified in respect of whatever aspect of assessment it waived the time limit on.

MR. LITTLE: That should accomplish our purpose.

MR. COYNE: It might serve some purpose and be a little less cumbersome.

MR. LITTLE: Yes.

THE CHAIRMAN: I think we could keep on asking and answering questions for two days, but with diminishing results, I feel, so let it be clearly understood that those paragraphs which we have not referred to, the parts of the brief we have not discussed, are equally important to us as those that we have discussed.

The procedure which we employ in our

organization, and it is no small organization, is that every bit of this will be dealt with very carefully and sorted and used thoroughly.

This has been I suppose the fullest submission we have had yet. It has covered more sections in the Act, and has gone deeper, than most briefs we have received so far.

We have received some briefs which went very deep, but this brief has been of tremendous importance and of the greatest help to us.

We shall use this as a constant source of reference. One of our very most important references, and there are many things that you have said to us which will undoubtedly find their way many times into our thoughts and considerations.

We might do worse than submit this as our report -- and a good one.

Thank you very much indeed, Mr. Little and gentlemen. I, as a member in the accountant profession, am indeed pleased with what has been accomplished here. It may be that we will come back to you again and ask your help in areas of this brief. I know that if we do, we will receive you, and you have always been most cooperative. I have always felt that our profession has shown a lot of public spirit and will continue to do so. Thank you very much.

MR. LITTLE: We appreciate very much those kind remarks you have made. If Mr. Howard Ross were here I know he would consider this a great privilege for the Canadian Institute to serve in this fashion.

Mr. Chairman, lady member, and gentlemen, I may say that this was a stimulating effort and we have enjoyed it thoroughly. We are very glad to have come here and met you in this friendly and informal atmosphere, in this Commission.

THE CHAIRMAN: Thank you. We will be dealing with excess at a later date. Our secretary, if he has not already done so, will arrange a suitable date. That is all. Thank you again.

Before we break, our secretary has one bit of business.

THE SECRETARY: I should add, that it has been agreed that you come back on January 23 and discuss chapter 2.

I would like to enter into the record as Exhibit No. 289 the brief submitted by the Institute of Accredited Public Accountants of Ontario, received in our office on December 2. That is all.

---EXHIBIT NO. 289: Brief of the Institute of Accredited Public Accountants of Ontario.

THE CHAIRMAN: The Commission stands adjourned until January 6th at 9:30 o'clock a.m.

---Whereupon the Commission adjourned.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

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OTTAWA

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ROYAL COMMISSION ON TAXATION

Proceedings of hearings held before the Royal Commission on Taxation in the Supreme Court of Canada Building, Ottawa, Ontario, commencing at 9:30 a.m. on Monday, January 6, 1964.

COMMISSION:

Mr. KENNETH LeM. CARTER -- Chairman

Mr. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

MRS. S.M. MILNE

MR. CHARLES E.S. WALLS

LEGAL ADVISERS:

MR. J.L. STEWART, Q.C.

MR. J. COYNE

RESEARCH DIRECTOR:

PROF. D.G. HARTLE

SECRETARY:

MR. G.L. BENNETT

ADMINISTRATIVE OFFICER

MR. A.J. SIM

Ottawa, Ontario,
Monday,
January 6th, 1963.

---On commencing at 9:30 o'clock a.m.

THE CHAIRMAN: Mr. Secretary, we may be a minute or so early, but I think we are all assembled.

THE SECRETARY: Good morning, Mr. Chairman and Commissioners. Perhaps I should wish everyone here a Happy New Year as this is our first submission in the New Year. It is perhaps fitting that the Canadian Manufacturers' Association are the group coming before you this morning, Commissioners.

Mr. H. Roy Crabtree, President of the Association, is leading the delegation. He will introduce his colleagues and then will be prepared to answer your questions. I would like to enter this brief into the record as Exhibit 290.

---EXHIBIT NO. 290: The brief of the Canadian Manufacturers' Association.

THE CHAIRMAN: Thank you, Mr. Secretary. Good morning, Mr. Crabtree and gentlemen. We are grateful for the submission that you have put to us and we will have a number of questions to address to you. We are indeed conscious of the importance of your Association in the national scene, particularly its relationship to employment. Naturally, our task is to recommend measures which are good for the Canadian economy, and we must therefore be very much concerned with the matter of Canadian employment. We are most anxious to hear all that you have to say on this, and indeed on other subjects.

This morning, gentlemen, we intend to use our counsel, Mr. Coyne, to lead in the questioning. We will, of course, ask questions ourselves. We have all read the submission, and there is no need to do that again. But before we ask our questions I would ask you, Mr. Crabtree, if you would care to introduce your people to us, and if there are any general or introductory remarks which you would care to make, we should be glad to hear them. We are very glad to see you all.

MR. H. ROY CRABTREE (President, The Canadian Manufacturers' Association): Thank you, sir. Mr. Chairman and Members of the Royal Commission on Taxation. On behalf of the Canadian Manufacturers' Association I would like to express our pleasure at again appearing before you, and this time to present our views on Canadian taxation. On the occasion of our earlier submission last spring, at your request we confined our comments to the discussion of those areas of taxation which in our view might be examined by the Commission. Today our task is somewhat different, since we are invited to discuss those associations' recommendations filed with you some short while ago, the recommendations as to ways and means whereby many of the more important and difficut tax problems affecting manufacturing might be resolved. This we are happy to do.

I might say that we are very much impressed with the magnitude of the job you have undertaken, and the fact that this exhibit has been registered as No. 290 is quite significant. We certainly express

the Association's compliments and commendation on the thorough and consciousness manner in which the Commission has been discharging and continues to discharge its important responsibilities.

As you know, we have long felt there was grave need for a searching and profound examination of Canadian taxation, and that this task has been entrusted to a Commission so eminently qualified is a source of much gratification, not only to the members of the Association but to Canadians generally.

I would like to introduce the members of our delegation. Mr. H.B. Style, the Second Vice President of the Canadian Manufacturers' Association and Chairman of the Board of John Inglis Company Limited; Mr. D.G. Willmot, Chairman, Ontario Division, The Canadian Manufacturers' Association, and President of Anthes Imperial Limited; Mr. W. Hugh Flynn, Chairman of the Taxation Committee, the Canadian Manufacturers' Association, and Ontario General Manager of Canadian Industries Limited. He is this delegation's chief spokesman, actually. Then we have Mr. J.G. McDonald, Chairman of the Subcommittee on Sales and Excise Taxes, the Canadian Manufacturers' Association, and he represents the Hobart Manufacturing Company Limited; Mr. R.B. Taylor, Vice President and Treasurer, The Steel Company of Canada Limited; Mr. J. Graeme Watson, President, E. & S. Currie Limited; Mr. Donald B. Strudley, Chairman of the Board of Imperial Furniture Manufacturing Company Limited; Mr. Keith L. Hamer, Vice President and Secretary-Treasurer, Addressograph-

Multigraph of Canada Limited; Mr. S.E. Ewens, Imperial Oil Limited.

We also have from the Association staff Mr. J.C. Whitelaw, Executive Vice President and General Manager; Mr. H.S. Shurtleff, Taxation Section; Mr. Richard Lang, Manager, Tariff Department; Mr. H.D. Potter, Economist; and Mr. C. Willis George, Ottawa Representative.

Mr. Chairman, I want to thank you for the privilege of making these few remarks, and I would now like to turn over our group to Mr. Flynn, who awaits your Commission. Thank you.

THE CHAIRMAN: Thank you indeed, Mr. Crabtree. Good morning, Mr. Flynn. I think that really the technical part of your submission starts with income taxes on page 8. Before getting to that, we note your general remarks with regard to the level of taxation. I would draw your attention at the commencement to page 7 , table II. I was rather surprised at the result of those figures. I had not seen quite the same tabulation before, I do not think. You have observed that direct taxation is laid on in such a manner as to be a severe burden, and if there was to be an increase in taxation it should be an indirect taxation rather than direct. That is your conclusion. However, I observe, if I look at Table II, that the indirect tax, just as a share of the total tax, has declined as a share of the total Federal Taxation from 26.6 per cent in 1957 to 21.9 per cent in 1963. That is seven years. I think the decline is about 18 per cent, as a share of the total.

Those are not absolute figures. As against that, of course, a larger share of the total is made up of tax on individuals, I observe -- 30.4 per cent against, now, 34 per cent. That is up 10 per cent, roughly. General sales tax has gone up likewise. But I think one should probably consider general sales tax as well as excise duties and special excise taxes, and taking them together I think the increase, as a share of the total taxes, is about 5 per cent.

Therefore it would seem to me that during that seven-year period there has been a relative lightening of the burden on corporations and an increase of the burden on individuals. Would you like to comment on that, Mr. Flynn?

MR. W. HUGH FLYNN (Chairman, Taxation Committee, the Canadian Manufacturers' Association): Yes, Mr. Chairman. The figures, as you say, are a little difficult to be precise with, but really our thinking here was that in total the direct taxes have been running, whether by accident or design, at approximately 60 per cent for the last seven years, and the total indirect taxes at 40 per cent. It is our feeling that even though corporation income taxes do appear to be less burdensome, according to these figures, than they were a few years ago, nevertheless we feel that in the interests of the economy as a whole there should be a greater proportion of the total revenue raised from indirect taxes rather than direct, which become in effect an addition to our cost of production in this country.

Mr. Taylor, would you care to go any further along those lines?

MR. R.B. TAYLOR (Vice President and Treasurer, the Steel Company of Canada Limited): I suppose one could say it should be a source of satisfaction to see the percentages, but to my mind it is more a matter of principle than exact figures in so far as the percentage of the "take" coming from corporations is concerned. The matter of competition has been mentioned. There are the fixed costs of manufacturing. Without going any further, we still believe that the principle of placing a tax on production is just not good.

THE CHAIRMAN: Is there any ready explanation, Mr. Taylor, for the change in the nexus between corporations and individuals here? Have the rates been altered, do you remember, during this seven-year period?

MR. TAYLOR: I am not an expert, I would say, on this; but the rate changes have not been significant. The incentives may have been. The dollar amounts of corporations have not increased nearly as greatly as the percentage. So perhaps the increase is more an incentive in other places rather than a decrease in taxes on corporations.

THE CHAIRMAN: It may be a change in the relevant size of the tax base.

COMMISSIONER PERRY: One thing I can think of is that the share of the corporate tax that is going to the provinces is more important now. In 1957 there

was a credit only for Ontario and Quebec. I should not say "only for Ontario and Quebec", because this applied to a lot of the provincial tax. In 1963 there was a credit for provincial taxes with every province. That alone would mean some reduction. At one time the credit was 7 per cent. I think that was earlier in 1957.

MR. TAYLOR: Of course, from our point of view the figures would be even more significant if the provincial taxes were put in as well. It does not matter to us whether the tax goes to the federal government or the provincial government.

COMMISSIONER PERRY: This would more properly reflect the total burden?

MR. TAYLOR: Yes.

THE CHAIRMAN: All you are intending to do in that table is indicate the constancy of the 60-40 ratio, I think. You are not really intending to go beyond that at this stage?

MR. TAYLOR: No.

MR. FLYNN: Mr. McDonald may have some thoughts on these figures, Mr. Chairman.

MR. McDONALD: Yes, Mr. Chairman. Is it your pleasure that we sit while responding?

THE CHAIRMAN: Yes, by all means. Sit and smoke and be as relaxed as you like, but don't all talk at once.

MR. McDONALD: There are two or three points that the Association would like to make with reference to this table or any other statistical review. It must be borne in mind that economic conditions also have

changed; that a mere comparison on bare arithmetic from the statistical table does not appear to be the answer. The Association is concerned with several factors with reference to the proportions of direct and indirect taxation and, as we will indicate later, with the effects of the present high level of taxes imposed on both corporations and individuals.

But one of the factors involves the rate of capital formation in the private sector of the economy and the effect that high direct taxes have, the inhibiting effect that high direct taxes have, upon the expansion of industry out of earnings, out of retained earnings. This is particularly true of manufacturing, where until very recently, and then only in a manner where none of the massive incentives and tax concessions that are found throughout the Income Tax Act are very much used. Manufacturing as a group of taxpayers has been left out of the contest of the past twenty years to achieve tax incentive benefits. The capital formation is not a subject upon which I am personally qualified to speak, but I am instructed to suggest to you, gentlemen, that it be given serious consideration by yourselves and by your staff in preparing your academic studies as background material.

The second point is perhaps of greater importance to industry and to the country as a whole. That is the competitive position both domestically and in foreign markets of Canadian manufacturing. When we say that economic conditions have changed, we direct your attention back in time to the immediate post-war

years when there was a world-wide shortage of raw materials and when Canada experienced an unprecedented boom. The development of the oil industry, mining, the natural resource industries generally produced a very substantial increase in the gross national product of this country and a very substantial collateral expansion of the service industry and the manufacturing industry to service the broadened base of the economy.

That post-war boom also produced substantial immigration, which of course was assisted by adverse conditions in Europe. Today there is a world surplus of most raw materials. Canada no longer calls the tune. In addition, Europe is very strong and competitive in the field of secondary industry. These are the changed conditions. It would be easy, perhaps, in 1950 to ignore the interests of the manufacturing sector of the private economy without doing damage to the country as a whole. It is much less easy today. In 1966 I believe the figures are that some four young people will enter the labour force for every one in 1940.

During the period from 1966 to 1970 a strong and growing manufacturing industry in Canada is the country's only real promise of continued prosperity and expansion, and for the first time perhaps in the last generation manufacturing industry now, and Canada as a whole now, have a prime interest in attending to the consequences of direct taxes on industrial profits.

The point, in brief, is that the competitive position of Canadian industry, in the opinion of this Association, is the key to at least the near future --

say, the five to ten-year future. This competitive position is both domestic and foreign. Later in the submission you will hear comment from members concerning the competitive impact of imported goods in Canada, goods that are manufactured in larger western countries where long production runs produce lower unit costs under conditions of, perhaps, lower labour expenses; but the important point is lower unit costs, effectively lower direct taxes on manufacturing industry, and all kinds of indirect and hidden incentives to exports which come right up to the line of the General Agreement on Tariffs and Trade.

The foreign manufacturer comes into Canada and jumps our tariff wall. The recent devaluation of our currency perhaps inhibited this to some extent and we may have some relevant comments to make on that in due course. But the point is that Canadian manufacturing is finding it increasingly difficult to meet competition from abroad; that is, for our domestic market.

It seems to me that we need to encourage industry to sell abroad. There is an exemption for sales tax under Section 44 of the Excise Tax Act, but this is not now, in 1964 conditions, as beneficial as it was a year ago because production machinery and apparatus is now taxable and there is no rebate of tax in regard to such machinery and apparatus when goods are shipped abroad.

To compete with foreign markets, the Association feel that the competitive position would be much improved if direct taxes were decreased. The short

point is that a lowering of direct taxation on industry would provide a real incentive to foreign management of parent companies to increase the proportion of world-wide output that is produced by their Canadian city, areas or branch plants. You will have heard on many occasions various figures concerning the proportion of Canadian industry that is beneficially owned or controlled abroad. In this connection Canada is unique. As Mr. Gordon, the Minister of Finance, has pointed out, no other country in the world, on a per capita basis, has such a substantial proportion, in absolute terms, of its industrial capacity either owned or controlled outside the national boundaries. Some $16 billion of United States direct investment is what is involved in this question.

This is an economic fact. One of the results of that fact is that many decisions are made which will affect us as Canadians and affect this country's economy.

If management say in Chicago are deciding whether to expand production in Montreal or in Amsterdam they look at Holland and they look at Canada and among many other factors that are weighed, they look at the tax structure.

Admittedly, Canada has many advantages that overseas countries lack but the Association's view is that if corporate income tax were reduced substantially to a rate not higher than 40 per cent, this would provide a strong inducement to foreign management to again increase manufacturing activity in this country.

Now, the Association's brief remarks on page 4 that "It is the view of the Association that the proportion of national revenue derived from direct taxes should be reduced".

Naturally, it would be Utopian to think that all expenditures of the National Government could be reduced so that no other taxes need be increased but we understand that is outside your Terms of Reference, and we say simply that if taxes must be raised elsewhere, if corporation tax is reduced, then the Association favours indirect taxes.

In that correction, as our Chairman will indicate in a moment, the Association's views are moderate. A corporate tax rate of 40 per cent would involve a revenue loss of approximately $300 million and $300 million is a small proportion of the total federal budget; yet the beneficial effects of such a reduction would far outweigh the immediate revenue cost and if the revenue gap had to be filled from Sales Tax of one form or another, the Association feels that such an increase would not inhibit the growth of the economy and would not be preducial to Canada's best interests.

THE CHAIRMAN: Thank you very much.

I think, perhaps, Mr. Flynn, rather than proceed further with Mr. McDonald's remarks at the present time, we might just go through your submission because that will in fact take us into a great deal of what has been said, not all of it, but if there is anything left over, we can go back to that.

Mr. Coyne, suppose you commence with income

tax on page 8, if that is where you are.

MR. COYNE: That is fine, Mr. Chairman.

I would like to ask just one or two rather inconsequential questions in this first section which deals with Federal-Provincial Fiscal Arrangements.

Mr. Flynn, in paragraph 16 on page 8 you state: "While the Association favours the fixing by each province of its own provincial corporation and personal income tax rates, it feels that it is essential that the federal government, through the Department of National Revenue, should collect these taxes on their behalf".

I am just querying the word "essential" which is rather a stronger word than I think we have ever heard in this connection before and ask you to perhaps indicate briefly why you feel it is essential that collection be made through the Federal Authorities.

MR. FLYNN: Well, possibly the word is a little strong but I think we feel that in the general interests of the economy in the collection of taxes and savings to the taxpayers in having to deal only with one return, that in the general interest of the country, it is most desirable -- as I say possibly "essential" is a little strong -- but very definitely, we feel it most desirable arrangements should be made between Canada and the provinces to get a uniform collection system.

MR. COYNE: Yes. But if it were not possible for this to be arranged for one reason or another, you would still be in favour of each province fixing its own corporate and personal income tax rates.

MR. FLYNN: I think that we can say that it is most important that the provinces should set their own rates and be accountable to their own people for the rates they set.

MR. COYNE: Well now, going to page 9, in paragraph 18 you make an interesting suggestion that the federal and provincial governments might set up a permanent secretariat which would meet regularly to discuss tax matters.

Are you able to expand in more detail as to how you feel such a group should be composed and how it would function?

MR. FLYNN: I think I would like to ask Mr. McDonald to answer that one.

MR. McDONALD: Yes, sir. There are really three objectives that the Association feels should be aimed at in connection with this whole matter. One is the uniformity of taxation, which is always a problem. The second is the simplicity of administrative procedures and to include the point of collection. And the third, of course, is that a reasonable cohesiveness of national policy based on federal provincial cooperation.

The Association feels that a standing or permanent secretariat of senior officers or provincial controllers of revenue and from the Department of Finance in Ottawa would certainly in the long term serve a very useful function.

It would improve the understanding in the provincial capitals and could deal with any problems of economic policy and planning. At the same time it would

ensure that the officials of the Federal Government are currently advised of provincial thinking.

This sort of continuing secretariat would, I think, on the Association's behalf, certainly make the perennial Dominion-Provincial Conference more useful.

COMMISSIONER PERRY: Mr. Coyne, may I ask if the Association is aware there already is a group which meets, not as a secretariat, but as a committee at least twice a year; in most cases it is the Deputy Provincial Treasurer and senior officials of the Department of Finance which meets at least in the spring and fall of each year and have for some time, to my knowledge, for this very purpose. It is not a publicized activity but it functions in the manner which you are suggesting for this Secretariat.

MR. McDONALD: Mr. Perry, the Association were aware of the existence of this cooperation but we were unaware of its extent and depth and feel that to the extent it has been found useful, it should be formalized and made use of more broadly.

COMMISSIONER PERRY: Thank you.

THE CHAIRMAN: Should this be a tax group or should it not be a fiscal group? Should it extend into economic planning in accordance with the National Economic Council which is, at the moment, I think, only federal. Do you believe that it could be useful if its terms or if its instructions are restricted to taxation?

MR. McDONALD: Mr. Chairman, I think that all of us will agree that every Federal-Provincial Committee should contain at least one economist and one

politician.

THE CHAIRMAN: I don't think you have answered my question.

MR. McDONALD: With great respect, Mr. Chairman, there is no facetiousness intended. The Association doubts whether any Federal-Provincial cooperation could be meaningful without proper consideration being given to economic policy and planning at the political level.

THE CHAIRMAN: Of which taxation would be one aspect.

MR. McDONALD: A very important aspect.

MR. COYNE: Well, then, if we might go on to the section on corporation income tax in paragraph 22 on page 12. You refer to the double taxation of corporation earnings. You recognize that this is to some extent mitigated by the dividend tax credit but point out this credit is small when related to the 50 per cent corporation income tax.

My question is simply this: Would you agree that for these small businesses which do not pay corporation income tax at the 50 per cent level, that the 20 per cent dividend tax credit pretty effectively eliminates double taxation of corporate income.

MR. FLYNN: Yes, I think it does in the small companies up to the $35,000.00 taxable limit.

MR. COYNE: You are really speaking here of the above $35,000.00 profits, the more substantial companies?

MR. FLYNN: Yes.

MR. COYNE: Well then, among the alternative solutions or suggestions put forward a little further on -- I am anticipating a bit here -- for the solution of this problem of double taxation, you do not include a suggestion that the dividend tax credit be increased. Has the Association given any consideration to the more extensive use of the dividend tax credit as a method of mitigating the double taxation on corporate incomes.

MR. FLYNN: Generally, yes. It has been considered but I think the view of the Association has been that the more desirable alternative, as we have set out in 28 and 29, first the elimination of the duplication of corporation income tax on dividend distribution. That is the first of the alternatives and not as desirable as the elimination of personal income tax on dividends received by Canadian residents.

We do not feel, I think I am correct in saying, that any increase in dividend tax credits would be as effective as either of those two measures.

MR. COYNE: Although, I suppose if the dividend tax credit were in fact made equal to the rate of corporate taxes, it would certainly eliminate double taxation. It might have other effects but it would eliminate double taxation of corporation earnings.

Let us, for example, talk in terms of a single corporation income tax rate of 40 per cent and a dividend tax credit of 40 per cent.

MR. FLYNN: Yes. Well, you would have to get away from the graduated corporation income tax.

MR. COYNE: Yes.

MR. FLYNN: On that assumption, if it was a flat 40 per cent corporate income tax and 40 per cent dividend tax credit, possibly that might work out but I am not sure. I wonder if Mr. Ewens would care to comment on that.

MR. EWENS: I think I would generally agree with counsel that if the dividend tax credit rate was made equal in some way to the corporate income tax rate we would eliminate double taxation. You would still have personal taxes paid on those dividends and the personal rates would be higher than the corporate rate.

MR. WILLMOT: May I make a comment on that? I think another point that is perhaps not stressed in this part of the discussion at the moment is that the Association feels that the retention of funds in the hands of corporations resulting from the elimination of double taxation would permit a higher level of reinvestment and a generation of employment opportunities within this country which I think would be more likely of direct benefit than if the relief of double taxation was in the hands of shareholders which might result in the funds being dissipated in many direct directions perhaps through the purchase of imported merchandise and so on. Would you agree with that?

MR. FLYNN: Yes.

MR. COYNE: You are suggesting from one point of view it would be more desirable to have double taxation eliminated at the corporate level rather than at the shareholder level.

MR. WILLMOT: I think that would be our

proposition.

MR. COYNE: Although, I suppose, by the same token the shareholders with their monies would then presumably save more and invest more and generate other beneficial effects of a different nature.

MR. WILLMOT: It would be a matter of degree, yes.

MR. TAYLOR: They would at least have the choice with their income, their increased income.

MR. COYNE: With the increased net income.

MR. TAYLOR: Yes.

THE CHAIRMAN: Mr. Coyne, before you go on, I find it very difficult to accept the fact that there is double taxation of corporate income. I think you will agree it would appear the succeeding recommendations are based on the premise that they are designed to eliminate double taxation. At the foot of page 10 you say: "The corporation tax is a hidden tax in its effect on consumers and workers and from this point of view is unsound. It undoubtedly adds to the cost of production, gives a price advantage to foreign goods, thereby highering the economy - etc.".

Mr. Flynn, would it not be true that if one-half of corporation taxes were passed on to the customers and employees, that the dividend credit would take away from that as to take care of any double taxation on the remaining half and there would be no double taxation whatsoever.

MR. FLYNN: Mr. Chairman, is it a valid assumption if you feel half of the tax may be passed on

to the customers?

THE CHAIRMAN: Well, we will deal with the validity of the assumption afterwards. Let us assume the assumption and on the basis of that assumption, can you answer my question.

MR. FLYNN: If half of the taxes were passed on to the consumer or customer.

THE CHAIRMAN: Yes.

MR. FLYNN: That the balance would increase ---

THE CHAIRMAN: The balance would be really offset by the dividend credit and that there would be no double taxes, taxes against shareholders.

MR. FLYNN: Upon the 20 per cent dividend tax credit.

THE CHAIRMAN: Yes.

MR. FLYNN: I couldn't answer that one specifically. How does the arithmetic work out?

THE CHAIRMAN: The tax rate is 50 per cent. Half would be passed on. The dividend tax credit of 20 per cent is close enough to 25 per cent. There may be some left but it would be a reasonable presumption.

MR. FLYNN: I think it would be beneficial to some extent. To what extent I could not say.

THE CHAIRMAN: Challenge the assumption, if you like. Say there is no tax or very little tax which is not borne by the shareholder. I drew your attention to the bottom of page 10 where you indicate that in fact you think it works against the consumers and workers.

In fact, I think most students have generally

arrived at this conclusion that the short-term effect is probably borne by the shareholders and the long-term effect is generally passed on over a long period of time and the dividend and corporate earnings are not reduced substantially because of the tax. They are immediately but not over the long period of time.

If that is sound, of course, I very much doubt if there is any double taxation of corporate income. You go ahead and make your point.

MR. FLYNN: Well, Mr. Chairman, over the last ten years the net return on investment in the manufacturing industry has been roughly halved. In that period the general world price structure has, we feel, prevented the manufacturing industries from passing almost any part of the high income tax rates to the consumers.

Now, that is a very general statement but that is our feeling.

~~Mr.~~ Style, would you care to elaborate on that?

MR. STYLE: I am not quite sure I get the point but it seems to me that if you could eliminate corporation tax, from the productive industry's point of view, it enables them to be more competitive either by being able to attract more capital or by being able to lower their costs or their prices to compete in the market.

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It seems to me that the whole essence of this thing is the competitive situation of Canadian industries, which must be hampered by any tax which is taken at the productive level.

THE CHAIRMAN: I do not think, Mr. Style, that you will really find much disagreement on that score. We have taxes in Canada. Twenty-five per cent of our gross national product is actually taken off in taxation. Somebody has to pay taxes at the point where the least damage is done. That is all one can say about it. But is it best taken off production and dumped on the consumer, or is it best taken off the consumer and dumped on production, or should it be somewhere in between? That is the purpose, or at least one of the main purposes of this Commission. If you dump the whole thing on the consumers you will dry up consumption. Now, you have put forward the counter argument, which of course bears validity. But we still have taxes, and we still have to meet them.

MR. STYLE: Well, Mr. Chairman, again I am looking at this as a manufacturer trying to compete in both the domestic market and the common market against the foreign producer. The advantage of having more taxation indirect, that is to say on the consumer, is that it affects equally our competitors in the domestic market from abroad as well as our situation in the export market.

COMMISSIONER WALLS: Mr. Style, I have one or two questions following on your remarks, if I may. The figures produced by the Manufacturers' Association in

1961, as I understand them, show that you have a 4.9 per cent profits after tax based on the net sales dollar. If I understand that alright, then if the corporation tax were removed it would therefore mean that the best you could reduce your prices would be by 5 per cent. Is this the action which you contemplate as manufacturers to take in the reduction of the prices, or do you foresee increasing the profit to your share-holders by 100 per cent so as to increase more equity buying?

MR. STYLE: That is a very difficult question to answer, sir, so far as industry generally is concerned, but I would say this. I would say that 4.9 per cent does not sound a lot. But 4.9 per cent, even if you took 2 per cent to decrease your prices and 2.9 per cent to improve your profits, could make a tremendous difference competitively. Most production is sold on a very competitive market and 1 or 2 or 3 per cent can make a terrific difference. That 4.9 per cent you are speaking about, sir, is in terms of your sales dollar. A far more illustrative figure is the return on capital investment. I think generally speaking that the return on capital investment, particularly in secondary industry, is too low perhaps to attract more investment. That is perhaps one of the reasons why such a large proportion of our secondary manufacturing is held outside the country. The limited amount of Canadian capital which we have is looking for better investment opportunities than we can get outside.

THE CHAIRMAN: That I do not understand, when you say that there is an inadequate return to

attract capital. I have noticed that most equities of successful companies sell at amounts which are in excess of the book value or in excess of the amounts which have been put into the companies. Therefore, it seems to me that Canadian industry is not generally depressed, because the fact that we put money to work in industry usually enhances the value of that money. Shares sell at 20 to 30 times over. I must say that prices look to me to be fairly high and not depressed. We do have people who come before us saying that it is depressed, that the situation needs encouragement. But surely the situation is attractive enough if people are going to pay those kind of prices. Am I right about that?

MR. STYLE: I do not think I am competent to answer that question, sir, but certainly that ratio stands with some of the successful companies. But I am talking about companies which are trying to build themselves up, and I do not think you get that ratio of the value of their stock in relation to their earnings.

MR. FLYNN: Perhaps I might say there that the criterion which many of us use is, if you invest money in a business, what net return will you get? I do not think in the operation of a manufacturing business that anyone pays too much attention to the market value of the shares, and so on; but they do find most important the net return they can get on additional money put into the operation. When you are running as low as 6 to 8 per cent net return on investment after taxes, it must be three or four times that before you would take the risk involved in investment of any magnitude with only

that prospect of such a low return.

THE CHAIRMAN: The average in Canadian manufacturing is roughly 10, is it not?

MR. FLYNN: I think the last figure I saw was about 7.

THE CHAIRMAN: The last ratio which I saw for sales was a little over 5, and nearly double that with capital. Am I not correct there?

MR. FLYNN: As I say, you may have had a more recent figure, but the last figure I saw was 7 and some fraction per cent.

MR. TAYLOR: With regard to your statement about shares selling at prices greater than book value, that is surely part of the result of inflation over a long period. I think another reason for the multiple times earnings which shares sell at in Canada is the scarcity of high-grade investments, equities, in Canada. Your figure of 20 to 30 I feel is high. The figure of 18 or 19 per cent in Canada, as opposed to 16 to 17 in the United States, is more like it. One of the reasons for this is that they have a scarcity value.

THE CHAIRMAN: Two other reasons which I can mention are the dividend credit and the lack of a capital gains tax. This is well demonstrated in recent figures which were published by the Tax Foundation. Have you noticed those?

MR. TAYLOR: Yes, I have.

MR. STYLE: I believe the figure for C.M.A. members for return on capital investment is of the order of 7 or 8 per cent.

THE CHAIRMAN: You do not have those with you?

MR. STYLE: No.

COMMISSIONER BEAUVAIS: Is that before or after tax?

MR. STYLE: After tax.

MR. FLYNN: If I may come back to your first observation about taxes and selling prices, a study by the Federation of British Industries may be of some help along these lines. Mr. McDonald here has it.

MR. McDONALD: For the record, Mr. Chairman, the reference is page 8 and the following two pages of the F.B.I. submission to the Richardson Committee last fall. In paragraph 8 on page 8, they say, in part:

> "...we think that direct taxes are, if possible, taken into account by firms in their price policies, although the fiercely competitive conditions frequently found in export markets greatly reduce the importance of the level of direct taxes as one of the determinants of export prices".

I might just say that the C.M.A. generally endorse this, and say:

> "The Canadian domestic market itself has many of the attributes of the fiercely competitive" ---

there is that expression again --

"export market referred to in the F.B.I. study".

Then the Federation of British Industries goes on to say at page 11, paragraph 15:

"Despite the important qualifications which we have made above" --

that is, the preceding commentary --

"we nevertheless think that profits in the long term are as good a criterion of efficiency as can be found, and that reduction of the burden of direct taxation on the profitable companies, accompanied by increased indirect taxation, might assist economic growth".

This is a well reasoned study. It is balanced and its views are endorsed by this Association on a general basis.

THE CHAIRMAN: But you must, of course, remember that they are talking about the British system of taxation. The gentleman did point out that as far as income tax is concerned there is no double tax, because of the practice of allowing grossing up of taxation and the credit privileges. But despite the grossing up practice and because we do not think there is double taxation in the U.K., they know there that there may be a passing on of the tax to the customers.

That has always surprised me. I would have thought under their system that there would be far less likely a chance of passing on taxation as there is under the Canadian system.

MR. McDONALD: I agree. The opportunities are stronger, but if competitive conditions inhibit it it does not take place to any measurable degree.

THE CHAIRMAN: With regard to corporation taxes, you pointed out at the beginning that the corporation can be regarded as a convert and that the tax is really passed on to the individual. That is in paragraph 20.

Therefore, I would ask this question. When a corporation is owned by non-taxable persons, such as a charity, or alternatively a lot of individuals who individually I doubt receive enough to put them into these tax brackets, or a government or a non-resident, should that corporation be free of tax because it is owned by persons who themselves are free of tax, or should the corporation, because it operates within the country and receives benefits of the country, and the protection of the country, not be subject itself to taxation? Are you taking the position that it should not be subject to taxation, other than passing tax through to its owners?

MR. FLYNN: I think, sir, that we are taking, or that the Association is taking, the view that generally, possibly an ideal ultimate solution, which may be many years hence, is that there would be no tax on corporate operations, and that the tax would be borne

by the individual shareholders resident in Canada. I can see from your question that there are special cases where, if the shareholders were not taxable, it would be almost in the category of a cooperative.

THE CHAIRMAN: Take the case of a charity, corporations owned by a charity. Should that corporation, which is competing with other corporations in Canada, be free of tax?

MR. FLYNN: Probably not.

THE CHAIRMAN: I think that if you are going to let it rest on the ownership, they are going to be free of tax.

MR. TAYLOR: If I might just say, the exception which you mentioned of corporations owned by charities, that is a different kind of exception to the one where you suggested perhaps that the individual owners of the corporation were themselves not earning sufficient amounts to be taxable. Then they should not be taxed, should they?

THE CHAIRMAN: Well, I do not know whether they should or not. That is what I am asking you. I think there is an argument in favour of taxing the corporation, even though the individual shareholders are taxable, don't you?

MR. TAYLOR: Yes, I do. But if ten men, say, owned a corporation which was making a profit, and that profit is divided among them, and each of them receives $1000.00 a year, it is not taxable. Why should it not be taxable, no matter where their income comes from?

THE CHAIRMAN: Are you distinguishing between them and a corporation, or not?

MR. TAYLOR: I am moving the corporation right out of the piece and letting it go right through to the individual.

THE CHAIRMAN: Well, I am not going to argue with you. You are putting forward the thought that the corporation, in those circumstances, should not be taxed, and that is all?

MR. TAYLOR: Yes.

THE CHAIRMAN: But if the corporation is owned by a charity, you say that probably it should be taxed?

MR. TAYLOR: Yes. That is the problem.

THE CHAIRMAN: If it is owned by a non-resident, should the owner be subject to the withholding tax, or should he have to pay full taxation?

MR. TAYLOR: That is another exception to which I have no answer.

THE CHAIRMAN: But that is the kind of case which arises here with converts. I think it is easy to dismiss the whole thing and to say that the corporation is nothing but a convert. But if you do that, then we are faced with a lot of rather difficult considerations.

COMMISSIONER PERRY: This subject is one which one could argue about on every statement which is made.

THE CHAIRMAN: It is very important whether one should tax a corporation or not tax a corporation. Therefore I am inclined to hesitate on that question.

COMMISSIONER PERRY: May I just raise a few points on this question. In paragraph 21, for example, the statement is made in the last line:

"Under no circumstances
can the tax be regarded as being
apportioned according to any just
or rational principle".

I think that one would agree with that, but it seems to me that what is operating here is the market. The way in which the tax is allocated results from the free play of the various factors of production in the market place. In other words, the investor, because the corporation is taxed, will want a higher return from dividends than from bonds, say, and this is what in fact happens. So you cannot say that there is any rational principle at play here. It is just the process of the various factors in the economy sorting out what they want from the corporation in order to be employed by them, or in order to invest in it or in order to lend it money. All of these things have to be satisfied and have to come into some sort of balance, else the corporations would not exist. They would have passed out of being.

All I am suggesting is this. The forces at play here are just the normal forces of the market which determine the way in which this tax will ultimately be borne. Whether you like it or not is something else. It cannot be described as a just or rational principle, yet it is the basis on which we are said to conduct our economic activity.

MR. FLYNN: Are you not really getting to the

root of the problem, that under today's conditions the high level of taxes is due, to some extent, to the growth in the private sector of the economy. Investment in the last few years has not been as large as it was previously.

COMMISSIONER PERRY: I wanted to come to that point. We were riding two horses here at a tremendous pace for a minute, and I am not sure whether we have not fallen in between them. Paragraph 23 carries the very provocative statement that we tax corporations mainly because of political advantage. I do not think that this is so myself. At least, I am inviting you to prove to me that it is so.

MR. FLYNN: I doubt if we could prove that it is so, sir. On this question it is quite logical to expect politicians to feel that they can increase corporation taxes without the same damage occurring as with an increase in personal taxes.

MR. TAYLOR: Would it be fair to say that when corporation taxes were first introduced they were done so because it was thought that there was no political disadvantage?

COMMISSIONER PERRY: I am not suggesting that politics do not have something to do with it. That is not the statement that you are making though. You say it is mainly of political considerations. I think it can be argued, as even the academic economists have been arguing, that there are real tax advantages in the postponement of income features devised for corporations.

MR. FLYNN: Have you a comment on that, Mr.

Willmot?

MR. WILLMOT: No, I do not think I can add anything.

MR. McDONALD: Mr. Perry, as you know the revenue from the corporation income tax is, I believe, running around $1.5 billion. Perhaps it is on the increase because of accelerated instalments. In the last taxation statistics, about three-quarters of the total was paid by about 400 companies. Out of 100,000 corporate returns, 400 companies paid 75 per cent, or more than $1½ billion. That is a very attractive well to cap, from a political point of view.

COMMISSIONER PERRY: I am only questioning your use of the word "mainly". Let me come to this point of the extent to which the corporation profits tax adds to costs of production and, as the statement appears at the top of page 11, "gives a price advantage to foreign goods".

This assumes, for one thing, that no other country in the world has a corporation profits tax, which we know very well is not the case. In fact, in some of the most competitive countries the tax is higher than ours. But I think the more important point was brought out in the discussion of arithmetic, and that is that when you really whittle this down to the content of the tax in ultimate prices, you come up with something much less significant than the 50 per cent rate which we are using as the measurement. In other words, in a good many industries the ultimate content of prices may be one, two or three per cent. I am very much impressed

with Mr. Style's statement that even this magnitude was important in price competition abroad. I am not asking you to disavow Mr. Style, but is this something with which all of you would agree; that when you really get down to the bidding, one, two or three per cent difference in price is a major consideration, or the deciding consideration?

MR. FLYNN: I think it is quite significant anyway. What would you think, Mr. Taylor?

MR. TAYLOR: Yes, I think it is significant. Other things being equal, a quarter of 1 per cent would mean a sale.

MR. WILLMOT: Mr. Flynn, we are dealing very much with averages. Let us assume that a Canadian corporation at the present time is doing most of its business in Canada and sees an opportunity to perhaps do 15 per cent of its volume outside Canada, and do that at marginal profit rates because of its overhead absorption, and so on. Then one or two per cent would make a tremendous difference in the impact on the price in that type of business.

I speak from personal experience on that. The impact of that on this extra volume of busines -- this one or two per cent across the board, as it were -- makes a substantial difference, Mr. Perry.

COMMISSIONER PERRY: That is the very sort of thing we want to hear.

MR. WILLMOT: A very substantial difference.

COMMISSIONER PERRY: In spite ~~of that~~, even your average increase in costs must be one or two per cent a year. You

might say this allows you to offset a one or two per cent increase in costs.

MR. WILLMOT: Yes; and there is a steady improvement in costs as the result of automation and mechanization. This produces an improvement in efficiency, and this is something which a corporation endeavours to build into its operation to offset it as well.

COMMISSIONER PERRY: The question we are discussing is almost parallel to the effect of foreign competition on prices and increased investment. There is no doubt that the corporation profits tax will inhibit investment. This is axiomatic. What, then, do you think would be the effect of increased investment on ultimate prices? This is a really silly question to ask, because you cannot answer it very precisely; yet this is involved in the point you were making, that you compete through prices; that the corporation profits tax inhibits investment. Therefore, I read from that that if you had more investment, you would be able to charge lower prices.

MR. WILLMOT: May I comment, Mr. Flynn?

MR. FLYNN: Yes.

MR. WILLMOT: I think the average Canadian manufacturer who is going to perhaps expand his volume outside Canada, first and foremost looks at the United States market. We probably, by and large, compete more readily, because of the similarity of price structure and standard of living in the United States, with them than any other market. I am generalizing for the moment,

but I think we compete more readily with them than any other country, where we are subjected to the impact of very much lower labour costs.

Our problem, fundamentally, is one of size. If this increased investment could be justified by competing in a broader market, you gentlemen are fully aware of the impact that volume has on an operation. There are many major commodities perhaps in the United States with high wage costs, and so on, but very much lower figures than those at which we can produce in Canada, entirely on the basis of size.

So you do get a benefit from this increased investment if it is justified by a broader market and a bigger volume. Averaging your costs, labour, material, overhead expenses, and so on, definitely will permit you to lower your costs, your selling prices. It is a matter of size.

THE CHAIRMAN: Presumably the impact of a tax on profits would not be severe in competition in the national market as would the same amount included in the cost which was payable whether or not you made a profit. I certainly recognize that when you are quoting in the national markets you must have regard to taxing, because you are only going to get what is left after paying tax and you must relate that to what is involved in the business and see that you get a proper return after taxes. But I would have thought the effect of a profits tax is much less than what the effect would be on your judgment if the tax was there whether or not you made a profit.

For instance, the social security tax at 3 per cent could well be a tax on payroll which would be a fixed tax and would have nothing whatsoever to do with profits. If that was done and the same amount was included, would that not be a more severe penalty on exports than is a three per cent tax on profits?

MR. TAYLOR: One part of the answer to that, Mr. Chairman, is that it becomes less flexible from the company's point of view.

THE CHAIRMAN: What does?

MR. TAYLOR: The tax on profits. It is a tax on labour. You still have your choice, to the extent that you can make a choice between labour and non-labour content.

THE CHAIRMAN: So that the labour-intensive industries would bear more in this regard than less labour-intensive industries?

MR. TAYLOR: Yes, Mr. Chairman.

THE CHAIRMAN: And success would not be penalized to the same extent. Therefore, if you are given a choice, which would you prefer? Are you prepared to answer that?

MR. TAYLOR: I will take the tax on profits.

THE CHAIRMAN: Yes, I would have thought so.

MR. McDONALD: Mr. Chairman, this may require some revision with regard to marginal pricing. I do not know whether the Commission has had its attention drawn to section 17 of the Income Tax Act.

THE CHAIRMAN: Yes.

MR. McDONALD: The Federation of British

Industries make the statement in their submission that a substantial proportion of British exports are priced to cover direct costs only. This is not permitted under Canadian tax law.

THE CHAIRMAN: It might also be prohibited by the dumping laws of other countries, might it not?

MR. McDONALD: Apparently it is not. It is merely a matter of accounting techniques.

THE CHAIRMAN: I would have thought that if goods were being shipped from Great Britain to Canada in this situation, they would run up against Canadian dumping rates, would they not?

MR. McDONALD: Yes, Mr. Chairman, but in most cases they do not reach that level. I have experience of litigation on this particular subject and I know that some Canadian companies have been afraid to expand European production in their factories because of their non-competitive position with reference to export pricing by reason of Section 17.

COMMISSIONER PERRY: I have some comments on Table III. I would just like to register the point that although this is an interesting comparison as between the burden of tax and the retention of earnings, it seems to me it is not really a very accurate measurement of the burden of the tax, because the other big element, which is just as important as the tax, is the extent of distribution, the variation in distribution policy between one country and another.

It is quite well known that this varies widely. Some European companies are making very extensive

distributions and are relying on equity financing to get the money back into the corporation. I admit this is not our North American philosophy, but simply from a statistical point of view I think this is a very serious question mark against the comparison that you make.

MR. McDONALD: If it is true that European countries and corporations have a more liberal dividend policy when compared with Canadian corporations, the figures in this table with reference to Canada should be increased. The point being made is of more value, if it is true.

COMMISSIONER PERRY: I do not think that is so, is it?

MR. McDONALD: This is the ratio of direct taxes on corporations to their savings.

THE CHAIRMAN: The Canadian figure would be about right, assuming that 50 per cent of profits are retained after taxes.

MR. McDONALD: Yes, if Canadian corporations retain relatively more of their profits after paying dividends than the other countries in the table.

COMMISSIONER PERRY: I have fallen into the usual trap of being precise. What I should have said was that a factor that is equally as valuable as the corporation taxes is the rate of dividend distribution, the rate of earnings distribution. Therefore this would be a valid comparison only if you had a constant rate in all the countries involved?

MR. McDONALD: That is correct. We think we have erred on the low side.

THE CHAIRMAN: I cannot follow your figures with regard to Belgium and Sweden, where I know they have corporation taxes at a rate of from about 35 to 43 per cent, or something like that. I do not see how these figures can possibly be correct; but I am not going to pursue it any further because in order to pursue it I would have to know what was the proportion of retention.

MR. McDONALD: The table is not submitted as an argument, but as an aid. The argument is based on the experience of the membership of the Association, from which the opinion has been formed that high taxes impose a burden on corporations with regard to the accummulation of retained earnings.

THE CHAIRMAN: We will move on to page 13.

MR. COYNE: Mr. Chairman, this really brings us back to a subject which we have already discussed to some extent. In the succeeding paragraphs the Association puts forward its suggestions with regard to the solution of the problem of double taxation. Of course, the first statement, Mr. Flynn, is that the ideal and logical solution to the problem of double taxation would be simply to abolish the corporation income tax. If this is merely put forward as being ideal and logical, but not practicable, there is not much point in my questioning you in too much detail. But on the assumption that we should pursue it a little further, I would ask you this question: If this solution were adopted, how, in the Association's view, would it affect the non-resident withholding tax?

What I have in mind here is the point which

I think arose out of the Chairman's discussion with Mr. Taylor. I think the basis for your suggestion that the corporation income tax be abolished is that the corporate earnings in the hands of the shareholders should bear whatever tax would be appropriate; and yet in this country let us say that something like 50 per cent of dividends from corporate earnings go outside the country and would not be bearing the same sort of taxes which apply to dividends received by Canadian residents.

I am just wondering whether, for example, you would propose, if the corporation income tax were abolished, to raise the withholding tax on dividends for a non-resident to, say, 50 per cent or some level of that magnitude.

MR. FLYNN: That would be rather difficult. We realize that possibly in this paragraph we have opened up a whole field, and having raised it, we should have gone into more detail as to how it would be implemented.

We recognize that, as you say, 50 per cent of industry, and secondly a large part of the resource industries are in foreign hands, and there would have to be some adjustment or change in the present basis of withholding tax. But looking at the thing ideally and broadly in the long term, and not the immediate future, we feel that there may come the day when it may be possible to eliminate corporation income tax.

MR. COYNE: Your point being that, as far as my question is concerned, your view would be that something would have to be done to ensure that the

corporate income drawn by non-resident shareholders bore some sort of fair share of the tax?

MR. FLYNN: I think that is correct. Just how it would be done, I could not say.

MR. COYNE: Would it be reasonable to couple with the abolishing, of corporation income tax, if it were to come about, a system of forced distribution of corporate earnings? In other words, would it be reasonable to couple with that a method to assure that some appropriate proportion of corporate earnings would bear tax in the shareholders' hands?

MR. McDONALD: I think that would be essential, Mr. Coyne. It would not operate otherwise.

MR. COYNE: Thank you. Going on to the succeeding paragraph, as an alternative to absolishing the corporation income tax you recommend that corporation taxes should be eliminated in respect of profits paid out in dividends to Canadian resident shareholders; and you suggest a method similar to the present United Kingdom system.

I would like to ask you this. Would this necessarily involve abandoning the two-stage corporation tax rate that we have at present -- that is, the 21 per cent and 50 per cent rates -- and make it necessary to have a single rate?

MR. McDONALD: I would think that the single rate would be necessary under this scheme, and accordingly that you would have the elimination of the dividend and tax credit.

MR. COYNE: This is inherent in this

recommendation that you put forward, although you have not specifically mentioned it?

MR. McDONALD: Yes.

MR. COYNE: Let me revert to an aspect we were discussing a moment ago. How would non-residents be taxed under this proposal?

MR. FLYNN: They would come, I think, under the present withholding tax system, wouldn't they, Mr. McDonald?

MR. McDONALD: Yes. The concept here is really more important than it seems on first reading. This is a proposal for a dividend paid credit with a single rate corporation income tax.

MR. COYNE: Let us assume, for the purposes of illustration, a 40 per cent rate, which is the rate that you mentioned earlier.

MR. McDONALD: Yes. In this case, in view of policy considerations, it is recommended that a dividend paid credit, or a deduction in computing income in the year in which the dividend is paid, be granted to corporations on the amount that has been paid out.

This has several effects. First of all, indirectly, in regard to the payment of dividends to Canadian resident shareholders, it reduces the effective rate of corporate tax. The shareholder himself pays tax at domestic rates with a dividend tax credit. A non-resident shareholder is subjected to withholding tax on the dividend he received.

Later in the brief reference is made, or comments are made as to the degree of Canadian ownership

under the provisions of Section 139(a). But if the rate in your hypothetical example, Mr. Coyne, were 40 per cent, and the withholding tax rates were kept at a level which would permit full utilization of foreign tax credits so that the foreign shareholder suffered no double taxation as between his own country and Canada, the position prior to December 20, 1960, would have been restored with reference to the foreign shareholder; and the position for Canada would have been altered in two major particulars: First of all, the corporation is paying a lower rate of tax -- I will not repeat the arguments concerning that reduction -- and secondly there is an incentive to make distributions to Canadian shareholders, which has the tendency to increase the participation by Canadians in Canadian equities. So there are strong policy pressures in this recommendation as well as technical tax concepts.

MR. COYNE: Getting back to the non-resident problem -- and I am not sure that I understood you -- as I understand the United Kingdom system, the dividend going to the non-resident is subject to the deduction at source at the standard rate of tax, which in England today is, I think, 37½ per cent. But as a non-resident he can then apply for a refund of the full amount of the tax. In effect, the United Kingdom does not tax non-resident shareholders of its corporations.

Is this what you imply in your system? Having deducted the 40 per cent from the non-resident's dividend cheque, what happens to it?

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MR. McDONALD: No, sir, it is not recommended that there be an exemption of dividends paid abroad from Canada. Canadian conditions are very different from United Kingdom conditions. The proportion from Canada is very much larger than the United Kingdom proportion.

MR. COYNE: So in your plan the non-resident shareholder would pay full tax at the standard rate on his dividends and would not be entitled to refund.

MR. McDONALD: He would be entitled only to pay tax under Part III of the Act, but at a rate we would hope, particularly in the United States, that it would not make his overall tax exceed his United States tax rate. If he is a corporate shareholder, the total of Canadian tax plus Canadian withholding on the dividend should not exceed 52 per cent of the current law.

THE CHAIRMAN: Does this recommendation seek to tax a non-resident at the same rate as a resident?

MR. McDONALD: No, Mr. Chairman, the resident taxpayer pays tax at the resident tax rate in Canada. If, bearing in mind the rate of persons who own shares, if he is an individual he would begin tax at between 35 and as high as 80 per cent although in fact the rate is between 35 and 60 per cent. The foreign shareholder would be paying at the withholding rate prescribed in the law.

THE CHAIRMAN: But he would also bear the tax imposed on corporations?

MR. McDONALD: The corporations tax is really a first stage tax which he indirectly bears.

THE CHAIRMAN: Surely you cannot have it both ways. In the case of a resident you are saying it is a tax on shareholders. In the case of a non-resident it must be a tax on shareholders also.

MR. COYNE: Although in the case of a non-resident he has two taxes, 40 per cent tax and withholding tax as well.

MR. McDONALD: I should make it clear that the deduction is for Canadian residents only. A corporation pays a dollar in dividends, 50 cents of which goes abroad and 50 cents of which goes to shareholders. The dividend paid deduction is only 50 cents. The non-resident shareholder is subject to withholding tax on his 50 cents. That income is after a 40 per cent tax levy at the corporate level. The combined 40 per cent plus withholding is less than his domestic rate. Therefore he gets a full foreign tax credit.

MR. COYNE: I am still not too clear about this. What happens to the Canadian domestic shareholder? Does he do a grossing up operation such as he does in the United Kingdom?

MR. McDONALD: No, sir, under our system, the unitary system we use, he would simply add his dividends to income and pay tax at the applicable marginal rate. The amount of dollars received would be added to income in the current concept.

MR. COYNE: Without benefit of dividend tax.

COMMISSIONER PERRY: I am confused about this. I am looking at 29a.

MR. COYNE: No, paragraph 29.

MR. McDONALD: There is ambiguity in 29. The end of the paragraph contains an unhappy use of language. There is a subsidiary thought in that paragraph which should be stricken. There is reference to a deduction and remission to the government of tax by a corporation. That is not intended.

MR. COYNE: I think the source of confusion is this. All of us here are reasonably cognizant, in a general sort of way, with the United Kingdom system which is really a payment by the corporation of tax on account of shareholders, the shareholders then ultimately grossing up the dividend in their own income tax return and taking a credit for whatever tax the corporation has paid on their behalf. I must say that reading this paragraph, this is initially what I thought you were proposing, but from some of your other remarks, I sense that it is not quite the same thing, that you are proposing a tax on the corporation.

MR. McDONALD: Yes, sir, and we apologize for the confusion.

MR. COYNE: Then subsequently a tax on the dividend in the hands of the shareholders separate from the tax that was paid by the corporation?

MR. McDONALD: Yes, sir. Perhaps I can make it clear by restating the parenthetical example.

MR. COYNE: Can we go one step further back? Take $2.00 of profits earned.

MR. McDONALD: $2.00 of profits earned would be 40 per cent.

MR. COYNE: To the corporation that is

corporation tax of 80 cents.

MR. McDONALD: The after-tax profit would be $1.20. Then assume the whole $1.20 is paid out in dividends to the shareholders, half of whom are Canadian resident individuals and half of whom, for the purposes of simplicity, are let us say United States shareholders, corporate or individual. The Canadian corporation would be entitled to deduct 30 cents in computing his income for the year of payment of the dividend.

THE CHAIRMAN: Where does that come from?

MR. McDONALD: Excuse me, Mr. Chairman, it is 60 cents, half of the total dividend.

MR. COYNE: But that is the whole of the dividend that is going to Canadian residents.

MR. McDONALD: The whole of the dividend is going to Canadian residents. This entitles the corporation in effect to a tax refund of 40 per cent of 60 cents, whatever that comes to.

MR. COYNE: How could this be credited? Let me just ask you this: ~~The corporation~~ in one year has already determined, on a basis of $2.00 profit, or the rates have determined that it would pay 80 cents in tax. I mean it would pay 80 cents in tax at a 40 per cent rate. Having then made profits, paid the 40 per cent tax and declared and paid the dividends, 50 per cent domestically and 50 per cent abroad, at what stage and to what profits or taxes does it attach this 60 cents credit? In the following year?

MR. McDONALD: I do not know that I fully understand the question, but the concept is that this

would be a continuing adjustment from year to year, depending on the dividend policy of the company. Later when we deal with estate taxes the suggestion will be made that the dividend paid credit people qualified for a carry- back before a prescribed number of years. But let me defer comment on that at this point. Taking one single year, the simplest example of all is the income of $2.00 and the payment in that year of a dividend of $1.20 after paying 80 cents tax. This is just a test tube arithmetical example. In that case you would get a refund. In practice, the corporation is paying instalments continuously and it will estimate its tax settlement six months after its fiscal period on the basis of the credits it has qualified for under the dividend paid credit. So it will pay the exact amount of tax that is due, but its retained earnings will be decreased by the credit. Its effective rate of income tax on profits will be less than 40 per cent by reason of the dividend paid credit.

MR. COYNE: Just reverting for a moment to $1.20 in dividends and leaving aside this question of the credit and at what stage it might become available, the dividends going to Canadian resident shareholders, aggregating in our example 60 cents, would then enter into the income of each of the individual resident shareholders and they would pay full personal tax on those dividends?

MR. McDONALD: Yes.

MR. COYNE: Whatever the rate might be?

MR. McDONALD: Yes.

MR. COYNE: Without benefit of any dividend tax credit?

MR. McDONALD: The dividend tax credit has indirectly been allowed at the corporate level by reason of the dividend paid credit.

THE CHAIRMAN: If you put together the indirect and direct effects, you have a tax equal to ordinary personal tax?

MR. McDONALD: Yes.

THE CHAIRMAN: You have a tax on non-residents equal to 40 per cent plus withholding?

MR. McDONALD: Yes.

THE CHAIRMAN: I think you end up with at least as high a tax on the non-resident as on Canadians?

MR. McDONALD: Yes.

THE CHAIRMAN: Surely you cannot put that forward as a reasonable proposal. People who do not reside in the country cannot surely be expected to pay the same amount to the federal government as people who reside here.

MR. McDONALD: A United States shareholder is taxable and what Canada does not take up the United States will.

THE CHAIRMAN: And you think it fair to tax the non-resident at the same rate as the resident?

MR. McDONALD: Yes, with the possible exception of foreign exempt institutions.

MR. COYNE: May I put this in order to resolve some of the confusion here. You mentioned the United Kingdom system, which is essentially a system

of taxing shareholders but not taxing corporations. That is over-simplifying it, of course, but basically that is the thesis behind the United Kingdom income tax.

MR. McDONALD: Yes.

MR. COYNE: As I understand your proposal, it is really quite different from the United Kingdom system and not by any manner of means the same system because you are speaking of a tax on the corporation.

MR. McDONALD: Yes.

MR. COYNE: The corporation will then take a credit against that tax to the extent of dividends which it has paid to Canadian resident shareholders, but that tax is still imposed upon the corporation and not upon the Canadian resident shareholders who have to pay their own tax in turn on the net dividend they receive.

MR. McDONALD: Yes.

MR. COYNE: And by the same token I suppose you might answer Mr. Chairman's question by saying the United States shareholder does not pay the 40 per cent tax, it was paid by the corporation.

MR. McDONALD: Yes.

MR. COYNE: He only pays the withholding tax on the amount of dividend remitted to him.

MR. McDONALD: Yes.

THE CHAIRMAN: Except that I said direct or indirect.

MR. McDONALD: Yes, that is quite so. Under current United States tax rates, this would give the United States shareholder an aggregate Canadian tax burden slightly below United States taxes.

MR. COYNE: Mr. Chairman, it strikes me that this suggestion, which is not really brought out in paragraph 29 and is nonetheless quite a novel and interesting one, might usefully be expanded in the form of a memorandum or something which would set forth quite clearly the ways in which you anticipate this system working, which I must say I did not in any way draw from the very short paragraph that you put in the brief. Would that be possible, Mr. Flynn and Mr. McDonald?

MR. FLYNN: Yes, Mr. Coyne. I was going to suggest that some of these words might be deleted but your suggestion to re-write it is a better one.

MR. COYNE: I was not suggesting so much that it be re-written as the submission of a little memorandum if you like, setting forth the system you are proposing and with perhaps one or two little alterations.

MR. McDONALD: There are other reasons underlying the proposal.

MR. COYNE: The reasons are something with which you might deal now unless you would prefer to expound them also in this memorandum.

MR. McDONALD: The first reason has been mentioned briefly. It tends to increase the returned earnings after tax at corporate level. The second reason is that it equates equity and debt financing within Canada. At the present time there is a favouring of debt financing because interest is deductible and the dividends are not. Furthermore, the conditions of Canada's money markets are such that we tend to favour

borrowing abroad. Under the current 1963 budget we exempt interest paid to foreign exempt institutions entirely from withholding taxes. So we are tending to encourage Canadian industry to finance by debt. This proposal would encourage Canadian industry to finance by equity offerings to Canadians. This is one of the types of incentives to Canadians to increase their ownership of Canadian industry, which the Association feels is to be preferred over sanctions to non-resident investors.

COMMISSIONER PERRY: In providing further explanation, will you explain why you simply do not do what I assume you are going to do in paragraph 28, that is allow the corporation a deduction of dividends paid to Canadians.

MR. McDONALD: That is what is intended.

COMMISSIONER PERRY: There is no tax credit involved?

MR. McDONALD: No, it is income credit.

COMMISSIONER PERRY: The British system has none of that. This is a very large red herring.

MR. COYNE: It is totally different from the United Kingdom system, certainly in methodology.

MR. McDONALD: There was some lack of coordination in drafting these paragraphs.

COMMISSIONER GRANT: It seems clearly to favour the corporation under this plan. The corporation tax of 40 per cent would be reduced to about 35.6 per cent with the dividend ---

MR. McDONALD: The more Canadian the company,

the greater the benefit.

COMMISSIONER GRANT: And it does include an inducement.

When submitting the supplementary memorandum on this, would it not be advisable for you to take into consideration the impact upon the shareholder that this would have under the additional burden which he would seem to be called upon to pay by way of taxes over which he is paying now when the 20 per cent dividend credit is eliminated?

MR. McDONALD: That point is very well taken and it has been discussed within the committee. The present yield in Canada from dividends paid to Canadian individuals is around $50 million to $60 million a year. The preliminary estimate we have made of the tax costs of the dividend paid credit proposal is around $200 million a year. This proposal therefore is very beneficial to Canadian resident shareholder individuals; it increases in effect their direct and indirect return from investments in Canadian equities by 400 per cent.

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MR. COYNE: Might I just say that increases are indirectly current, but for the shareholder paying tax next year rather than paying it this year it certainly reduces the return next year.

MR. McDONALD: That is true. The degree of benefit will vary according to the marginal tax rate which is applicable to each shareholder. We have further comments on the question of personal income tax which may answer that question, particularly the very high rates which are unrealistic.

COMMISSIONER GRANT: Might I just ask you this. If you did not have progressive personal tax rates, it would not have as much of a bad effect on the individual.

MR. McDONALD: Some people think that individuals should not be called on to pay tax at a rate higher than that paid by General Motors, say. Perhaps we will come to that later, but the level of personal taxes is a very important subject.

THE CHAIRMAN: I think we might just break off now for ten minutes. When we come back I should like you to consider whether we should remove sales tax. You might like to discuss that with Mr. Flynn, because I have two members who wish to deal with the sales tax question.

---A short recess.

MR. COYNE: Well, Mr. Chairman, the suggestion has been made that we might go on to the sales tax section of the brief in order to make sure that we

get through this part while the gentlemen concerned are here, and that we then revert to the earlier part later. Therefore, we might turn to page 31 of the brief where the sales tax section commences.

Mr. Flynn, your principal recommendation in this field is that the present federal sales tax should be replaced by a national sales tax imposed at the retail level, and extended to services as well as goods. You point out the advantages which you feel such a tax would have over the present manufacturers sales tax. Could you say whether the Association gave any consideration to a sort of intermediate shift of the tax base from the manufacturers level to the wholesale say, rather than to the retail level? Would there be any advantages to a wholesale tax over a manufacturer's tax?

MR. FLYNN: Mr. Coyne, some consideration was given to that. I realize that in the suggestion of a national retail tax it would extend the number of tax payments very substantially. You would have a smaller body to deal with than at the wholesale level, but we felt, I think, that on balance the tax at this level on a national basis would be preferable to a wholesale. Would you care to elaborate on that, Mr. Hamer?

MR. HAMER: I think that a wholesale price in the case of a manufacturer, who might distribute directly to the public, would have to be an administrative price. You might get into the same situation as at the moment, whereby you actually pay less sales tax by importing the product than if it were manufactured in

Canada, which has the tendency of reducing manufacturing in Canada at a time when we should like to add to the labour force. I think you would have to have an administrative price. If it were to go on the selling price you would have a market price which sets the tax.

MR. COYNE: Are you saying, in effect, that a wholesale tax at the wholesale level would be less satisfactory, in your view, than a tax at the manufacturer's level?

MR. HAMER: No. It would create the same situation. It would not improve it. It would not have cleared the problem of paying more when you manufacture in Canada, as opposed to importation.

MR. COYNE: It would improve some aspects of the present situation you complain of though, would it not?

MR. HAMER: In those cases where you have a wholesaler involved in the distribution cycle; but in those cases where a manufacturer distributes directly you would have to have a set wholesale price by administration of the tax. That is where you might get into difficulty. Your value is set by a sales tax administration, whereas your importing value is set by the customs division on two different sets of principles.

MR. COYNE: This is a particular difficulty, Mr. Flynn, which a wholesale tax would not eliminate.

MR. FLYNN: Yes, that is right.

MR. COYNE: I suppose also that it would not lend itself to this basic idea which you put forward of

a national sales tax, because the provinces, of course, only can tax at the retail level.

MR. LANG: That we recommended a change in the tax from manufacturer to wholesaler and from wholesaler to dealer was because a large proportion of the distribution of goods in Canada is handled by a few large volume retailers, and this would not solve the basic problem. They are considered to be wholesalers for the purpose of the Excise Tax Act now, and in effect a change in the basis of value of the tax would give them a more competitive advantage than they have now.

MR. COYNE: Is this factor which you mention more peculiar to Canada than, perhaps, to some other countries?

MR. LANG: Yes, it is.

THE CHAIRMAN: What was the answer to that?

MR. COYNE: The answer was yes, Mr. Chairman. It is the preponderance of distribution in the hands of a relatively small number of large retail operators.

MR. STRUDLEY: Would it not be possible to tax services at the wholesale level? Is that another reason for going to the retail level?

MR. COYNE: I am not sure. There may be a difficulty there. There are difficulties about taxing services anyway, and perhaps we will come to some of those during the course of our examination of this brief. That could be another factor though for suggesting the retail level as you do. What do you think would be the rate of this national sales tax if it were levied at the retail level? Sometimes it is suggested that,

bearing in mind the varying provincial rates of tax, it would be of the order of 10 to 13 per cent on the retail selling price. At that level would your experience suggest that there would be much risk of widespread evasion of tax, or attempts to evade tax, it being such a significant part of the total cost to the consumer?

MR. FLYNN: Well, Mr. Coyne, the figure which has been mentioned is roughly 7 per cent, without extending the tax to services. If the retail national tax was extended to services, possibly it would be less than 7, which would be only at present rates of tax. So to that extent, if you would have some province with 6 per cent and a national, federal tax at 6 or 7 per cent, we would be up to 12 or 13 per cent in that province.

COMMISSIONER WALLS: It seems to me that there must be some misunderstanding here. I can understand that if you are going to continue the present level of sales tax it would be 13 per cent. But as I understand the brief, you suggest the removal of the corporation tax, the lowering of the progressivity of the personal income tax, and then further you suggest the elimination of the excise tax, which is another $221 million. If you are putting all this on a retail sales tax, it would be a 30 per cent tax, as I work it out. If you replace all of these taxes which you mention in your brief by a sales tax, you would have to have a 30 per cent sales tax.

THE CHAIRMAN: Without services.

COMMISSIONER WALLS: Yes, that is so.

MR. FLYNN: I do not think that we have

suggested that the retail sales tax should replace all the other factors we have commented on.

COMMISSIONER WALLS: I certainly took that from the beginning of your brief, where you said that it should come off direct taxation, not off indirect taxation. Your number one suggestion is, I think, the removal of the corporate tax entirely, and the second one is the reduction in some of the progressivity of the personal income tax. Then further on, although I do not want to go into it now, you suggest the elimination of the exicse tax. I do not know how you would do that unless you put it on a sales tax, and if you did that you would have a 30 per cent retail sales tax.

MR. McDONALD: With your permission, Mr. Chairman, may I reply to this question. First of all, may I make this point by way of emphasis. The C.M.A. is not as a practical matter recommending the abolition of the corporation income tax. I think we made it clear that there was a great deal of difference between theory and practice. The recommendation is that the corporation rate be reduced significantly to a rate not exceeding 40 per cent. The revenue cost of this reduction is $300 million; that is, one-fifth of the current yield. The yield from indirect taxes is around $2 billion, or slightly over that at the present time, and the retail sales tax ---

COMMISSIONER WALLS: Just one second. You are including in that customs tariffs and excise tax and excise duty?

MR. McDONALD: Excise tax and duties.

COMMISSIONER WALLS: But you are including the

customs tariff?

MR. McDONALD: Yes. That is a mistake. The figure is less.

COMMISSIONER WALLS: It is about $1.5 billion otherwise.

MR. McDONALD: Yes. A rate of, say, 12 to 13 per cent for a national retail sales tax would produce a yield equal to the present yield from the manufacturers sales tax, federal, and the present yield of the provincial sales taxes. It is federal and provincial. So there is no net increase at the provincial level.

The $300 million referable to the reduction in the corporation income tax should be added to the estimated $200 million, which would arise from the dividend-paid credit. That is a total of $500 million out of the federal budget of $6 billion; that is to say, one-twelfth. That is the net adjustment.

COMMISSIONER WALLS: What about your $221 million which we have from the excise tax, which would have to be added to the other items?

MR. McDONALD: That is covered in the twelve and 13 per cent figure. The only exclusion was the Customs tariff.

COMMISSIONER WALLS: No. If you carry it through to the retail you would estimate it to be 8 per cent retail. Your present 11 per cent manufacturers tax carries through to retail.

THE CHAIRMAN: I think that estimate is Professor Due's estimate.

COMMISSIONER WALLS: Yes, it is. It would

depend on the degree of pyramiding which is carried out.

MR. McDONALD: The point I wish to make is that the figure of 30 per cent is quite unnecessary because the corporation income tax yield would still be $1.2 or more under our proposal. The C.M.A. is very conscious that if a retail sales tax level goes beyond a certain point it may inhibit volume.

COMMISSIONER WALLS: Just taking the points you have mentioned here, you are going to look for $300 million from corporation tax, taking your second formula for reducing to 40 per cent. You have $220 million of excise tax. You also have the amount -- I do not think you put a figure on it -- of the reduction in the progressivity of the personal income tax.

MR. McDONALD: I will come to that later, but the figure is very low, about $30 million a year.

COMMISSIONER WALLS: It will bring it up to about $600 million as against $1 billion. The present sales tax by itself, outside of excise tax and excise duties, is about $1 billion. Therefore you are increasing $600 million on that. You are increasing that by 60 per cent. Therefore you have increased your 8 per cent by 60 per cent, which is about another 5 per cent, plus your provincial sales tax of, let us say, 5 per cent. So we are at least up to an 18% retail sales tax.

MR. McDONALD: I will have to verify these figures on federal yield and I will be speaking to that in a few moments, if I may.

COMMISSIONER WALLS: Surely. I wonder if I could carry on with that point. Supposing it requires

that type of tax, do you foresee any difficulty in getting the provinces to agree to combining on the tax as a visual tax, where the consumer would know that the amount -- whether it happens to be 13 per cent or 18 per cent, or even 30 per cent -- is added extra to the selling price? Have you any reason to think that the provinces would agree to that?

MR. McDONALD: The C.M.A. thinks that the public should know what tax it is paying. The question is whether the sales tax should be revealed at the point of sale or left to the local option. I would say that it is recognized everywhere, I think, that a visible retail sales tax which which is seen by the housewife when she goes into the shop is something that falls in a different category than an income tax, where taxes are withheld at source and this in fact is not realized at the time.

When in Ontario the 3 per cent retail sales tax was introduced, it was introduced with trepidation and fears of a great public outcry because of its visible character. There was, in fact, practically no objection Rumour now is that it will be increased to 5 per cent by next year, and the anticipation is that there will be no public outcry against it.

COMMISSIONER WALLS: Coming from a province where we already have the 5 per cent, I would say there is a continual outcry against it. I would just ask -- I do not know and I was wondering if you do -- whether the provinces would not fear that when it is increased, they would be blamed for the increase.

MR. McDONALD: This is one of the reasons, perhaps, for considering federal collection.

COMMISSIONER WALLS: As an alternative to that did you give any consideration to it being a hidden retail sales tax?

MR. McDONALD: I think if we were entirely motivated by practical, political considerations, the tax should be so formulated that it need not be disclosed in the sales paper. This would be the ideal solution from that standpoint.

THE CHAIRMAN: Perhaps you would carry on, Mr. Coyne. There are one or two points you have raised that I want to go back to in this regard.

MR. COYNE: The next point I was going to just raise briefly. Perhaps it is not too fundamental. Of course, many more business establishments would be involved in the collection of the tax at the retail level. Has the Association made any study, or has it any ideas, as to the relevant costs of collection and administration of a retail tax as compared with a manufacturers' tax?

MR. LANG: Not in respect to the cost, but I think we are motivated to a large extent by the fact that seven of the nine provinces already have provincial sales taxes, with their administration and collection, and we are expecting that Manitoba will have one fairly soon. So that we are dealing with a situation where we have nine different sales taxes and one which would have the same exemptions and the same rules of administration and collection, which would be much more satisfactory from everyone's standpoint.

MR. COYNE: In other words, a great deal of the costs are being incurred at the present time as the result of the existence of the provincial sales taxes?

MR. HAMER: They are already there.

MR. McDONALD: If I may interject, Mr. Chairman, you asked the question a few moments ago concerning our views on the question of avoidance of sales tax, and it was not answered.

MR. COYNE: That is correct. Thank you.

MR. McDONALD: I would like to suggest that I believe there is an adequate audit procedure which could prevent avoidance. The income tax returns must be filed by all corporations whether or not they have a profit. Steps should be taken to amend the Income Tax Act to require the filing of income tax returns by all tax-payers who sell goods that are subject to sales tax.

MR. COYNE: Or services?

MR. McDONALD: Or services, whether or not they have a profit. The machine coding which is used for T.1 general returns and some T.2 statistics and the impending machining of National Revenue would permit a cross-check for the sales tax division of the Department in which the sales figure is taken off and the rate of tax applicable to the province determined by the computer. This would be an annual audit check on the sales tax returns of the retailer and would automatically throw out the files that appear to be wrong, or the returns that appear to be wrong. These could then be subject to field audit. But with the income tax system and the present I.B.M. procedures there is a system which would

cut down tremendously the cost of field auditing.

MR. COYNE: And this would also, in your view, be an adequate control, if you like, over any tendency to avoidance that might be present in a relatively high rate of tax?

MR. McDONALD: We are hopeful that if the taxpayers know they are subject to annual audit, and any significant variation in regard to the figures will bring a field auditor to his place of business, he will be induced to file true and correct tax returns.

MR. COYNE: And to collect the proper sales tax at the time he should collect it?

MR. McDONALD: He will be made liable for the tax, if he did not.

COMMISSIONER GRANT: You would have to allow some variation for those sales, would you not, which were not subject to tax?

MR. McDONALD: Yes; there would have to be an adjustment, a margin of error.

COMMISSIONER GRANT: Which would vary with different types of businesses?

MR. McDONALD: Yes. There is always a certain degree of slippage in this question, and the extent of that slippage has to be met after considering the administration cost of narrowing the gap, so to speak.

COMMISSIONER GRANT: You are going to take the total sales figure and relate the tax which that industry or business should pay to the rate of retail sales tax in a province?

MR. McDONALD: Yes. I think it can be done

by a commodity analysis, by a code system. A retail food distributor, for example, would be paying very little tax, if any. He would have a different code classification than someone selling predominantly taxable goods.

COMMISSIONER GRANT: In a department store the food marketeria would have to give a separate breakdown of sales?

MR. McDONALD: Settle his code category by agreement with the adjustments branch, on the basis of his experience over the past two or three years; and each code category would have a percentage factor. If he felt that percentage factor in future had become unrealistic, it would be up to him to go to the authorities.

THE CHAIRMAN: Have you finished with the national sales tax question?

MR. COYNE: I was going on to ask one or two questions about the tax on services, Mr. Chairman.

THE CHAIRMAN: Before you do that, I have two or three matters with which I would like to deal. I think we can all agree that if we are going to have a sales tax, the ideal place is as close to the consumer as possible for the tax to be applied. There are a great many difficulties in that, in that we are a federal country and it requires cooperation between the different levels of government in order to achieve this. This may be a perfectly reasonable objective; I do not know.

But if it is not, one is faced with either

going straight ahead and having it imposed by the federal government at the ideal level, letting the chips falls where they may, or trying to find some other level. In the alternative that it is a bad thing to move into the retail level for the moment, I just want to pursue Mr. Coyne's questions as to the difference between a tax at the wholesale level, which I interpret as being a level at which the retailer buys his goods and the prices paid by the retailer for his goods from whomsoever he may buy them, as opposed to the manufacturers' level.

You have said that the wholesale level -- I think Mr. Hamer indicated this -- did not cure the import problem. I do not suppose it will cure all the import problems, but I suggest to you, Mr. Hamer, that if many importers were licensed, at least the trouble would be removed from the border to the next level at which the goods were sold. If one did move to the wholesale level, wholesalers would be licensed and those people supplying retailers would be licensed, although the retailers would not be licensed. Therefore a great number of importers would be licensed. The tax would then be collected on the Canadian market price rather than at the level of the import.

That would, I think, from what we have been told here, go some distance to curing the import problems, although it might not cure them all.

As to the valuation problem, again, the valuation problem is caused largely by the fact that manufacturers sell to wholesalers and retailers, and perhaps sometimes sell to consumers. If the wholesaler

were licensed and the price was the price the retailer paid, on which the tax was collected, if he paid the same price to the wholesaler as he paid to the manufacturer there would be no problem, I would assume.

I think the problem remains, though, as to the different mark-ups perhaps required by the large retailers as against the smaller retailers, and probably the large retailers perform certain wholesaling operations. If they do, it puts them out of line with the people who do not perform wholesale operations. Have you thought about whether or not there might be a cure for that?

There are other countries which have made adjustments in these circumstances. The adjustments have to some extent been rough. There is one country -- I think it is France -- which applies their T.V.A. only to those retail outlets which have more than four stores. There are other countries which employ other methods. Australia applies an uplift for imports of 20 per cent.

It may be that one can seek some kind of factors which would produce a fair measure of equity better than those we now have. I was wondering if you had directed your mind to that area, or if you had simply decided you would like to have a national sales tax and had stopped at that point and had not gone very far into any alternatives.

MR. HAMER: I think, Mr. Chairman, that where the manufacturer sells directly to the consumer you still have a fixed price that is fixed by the administration.

THE CHAIRMAN: Unquestionably. But there are

not many transactions of that kind. There are some.

MR. HAMER: When you get into that area, I think the administration is more difficult, as opposed to the selling price.

THE CHAIRMAN: Well, it would be easier than things are now.

MR. HAMER: Yes; there would be an improvement over the present system.

THE CHAIRMAN: Yes. The candy stores which sell retail now have a very substantial adjustment. They would still have an adjustment, but it would be a smaller one, and there would be fewer companies concerned with such adjustments.

I think the real difference is the one you originally stated, namely, that between the large merchants and the small merchants. That is a very difficult question and I was wondering whether you have any solution for that. I take it that you have not.

COMMISSIONER WALLS: This brief deals with some of the difficulties you run into at the present time. I think the Chairman answered quite effectively the one with regard to imports, by following a procedure similar to that used in Australia and applying an arbitrary 20 per cent to bring it to the equivalent of the wholesale price.

At the top of page 33 you deal with this question and say:

"It places on an equal tax
base those goods imported or
purchased in bulk for re-packaging

for resale in Canada and those goods manufactured in Canada for sale."

With regard to Canadian manufactured products the sales price of course includes the cost of the packaging, which is taxed on that basis; and on the imported article it is on the duty paid value, which also must include the cost of the packaging.

As far as re-packaging is concerned, we know that chocolate, candy, pharmaceutical and cosmetic repackagers are all considered as manufacturers and pay tax.

What other type of packaging do you say you are up against and are at a disadvantage with as compared with imports, because it would seem to me that these are the main products that would come into the country for re-packaging?

MR. LANG: There are still a number of other things. It is true that the recent amendments to the Act have taken care of the main problem dealing with other packaging; but it is still provided in the Act that sales in bulk represent the value for tax and you can buy your containers, packages, cartons, separately. This is discrimination against the manufacturer who does all those operations in his own plant.

COMMISSIONER WALLS: As I understood it, the main complaint before dealt with pharmaceuticals. What I am trying to get at is this: What other products do you re-package in Canada, outside of those already considered to be manufactured in Canada and packaged?

I was just wondering if we had not solved the problem pretty well already.

MR. LANG: To a large extent, that is true; but not altogether.

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COMMISSIONER WALLS: I was very interested to get your ideas on what you meant by paragraph 98:

"...the Excise Tax Act as presently constituted has failed to take into account or make provision for many of the newer manufacturing techniques...."

I wonder if you could enlarge on what was meant by that.

MR. LANG: I might just comment on the question of manufacturing techniques, marketing methods and distributing procedures merely to emphasize the point that the excise tax, while we know it has been under study for a number of years and particularly in the light of the excellent report the Chairman here brought down in 1956, still has not been amended and therefore these problems of discrimination between different industries, different marketing procedures, etc., continue. One example is in the marketing techniques of pre-fabricated kitchens. When a carpenter himself builds a kitchen in a house the carpenter only pays tax on the materials whereas in other cases the tax applies to the manufacturer on the full price. You have the question of premixed concrete where the prices are determined on the basis of the miles from the place where you are going to deliver. A special provision has been made to take care of this.

COMMISSIONER WALLS: Were these not corrected in 1952?

MR. LANG: Yes, but these are the sort of things we are referring to -- marketing methods, the

question of cooperative advertising, warranty financing. This type of charge is a service charge really and it is taxable because it is included in the sale price.

MR. McDONALD: The latest problem, Mr. Walls, is retread tires. In September they were made taxable in certain circumstances. A delegation from Toronto has gone to Customs and Excise today trying to find a solution.

COMMISSIONER WALLS: Paragraph 103 is quite short. It says:

> "The Association recommends that the Excise Tax Act be amended to provide statutory authority for the use of a wholesale price for the purpose of determining sales and excise taxes."

Are you not really in effect saying here that if the federal and provincial negotiations should not arrive at agreement for combined retail/sales tax, what you then want is a tax at the wholesale level?

MR. LANG: No, that is not what we mean. The question of using wholesale price at the wholesale level is two different things. What we are saying here is that there should be statutory authority in the Excise Tax Act for providing that the tax be paid on a reasonable price from a manufacturer to a wholesaler. That is what we mean.

COMMISSIONER WALLS: If you are going to do that, might you not just as well go into the wholesale tax and be done with it -- if you are going to use that

as a basis of tax?

MR. LANG: At the present time it is on the actual sale price and while in the regulations the Minister has tried to take care of this problem it continues where different industries are concerned, some pay at the manufactured price to the wholesaler whereas others pay at the prices to the retailer. As long as there are no statutory provisions there is no right of appeal, and it is left entirely in the hands of the administration to determine what constitutes the sale price.

COMMISSIONER WALLS: Going along to paragraph 109, you then wish to reduce from the sales price the cost of advertising and financing and so on, as was mentioned previously. Would it not be administratively difficult to separate these factors which normally make up your selling price so that some of them would be exempt from price?

MR. LANG: Not administratively difficult,no. In most instances that is what a manufacturer does. He sets it down on his invoice and the purchaser, the wholesaler, has to comply with certain conditions in order to get credit. But for the fact that it is the invoice price the Act provides no alternative, so therefore there is no alternative.

COMMISSIONER WALLS: There would be no great difficulty administratively?

MR. LANG: No.

COMMISSIONER WALLS: How would it work out from the Department's point of view for checking?

MR. LANG: I do not think there would be any difficulty at all.

COMMISSIONER WALLS: Then you say in the next paragraph:

> "....Since excise taxes are expressly excluded from the sales tax base by Section 29(1)(f)(i), the Association feels that Excise Duties payable under the Excise Tax Act should also be excluded."

But excise duty items carry a like duty to the import tariff on the same product. I am talking now, of course, of liquor and cigarettes where the excise duty is practically identical with the tariff of the like imported products.

If you are going to put the sales tax on the imported product plus the customs tariff, surely it is equally fair then to put the sales tax on the excise duty of the domestic products.

MR. LANG: You will have to make the adjustment in both instances.

COMMISSIONER WALLS: There would be very little adjustment because your $13.00 per gallon proof spirit on liquor is identical between the import customs and the excise duty, so if you are going to put the sales tax on the import at that price then I think it is equally fair that you put the sales tax on the excise duty of the domestic product.

MR. COYNE: If I might revert to one aspect of your proposal national sales tax, of course a very

important aspect of this is your recommendation that this national tax be extended to services. I would like to ask you what you mean in this context by services. That is, do you include all services of every kind which are rendered by people in the business of providing services or do you envisage only those particular services such as barber shops and dry cleaning establishments, etc., which are normally rendered to private individuals as consumers? What services do you propose should be subject to this tax?

MR. FLYNN: I think generally speaking a broader base is expected.

Would you care to comment, Mr. Hamer?

MR. HAMER: This was part of a thought of getting more revenue from direct taxation as opposed to indirect taxation by bringing services under national sales tax. This would partially accomplish this.

MR. COYNE: If it is as broad as that, how do you deal with the problem which will inevitably arise of multiple taxation, with which you are very much concerned, as far as goods are concerned?

I can pose a simple example. You are extending your line of machinery and plant and you have to hire engineers to design the layout or advise you on the installation. Those engineers are providing a service, and I take it from what you say that that service is going to be taxable. On the other hand, the ultimate goods are going to be taxable too. The services would be taxable, but the production machinery that the engineers are designing would not, under your

proposal, be taxable? Are those the implications that are involved? Are we to think that the engineering fee that you pay on production machinery is to be taxable?

MR. FLYNN: No, the thinking is that services entering into the cost of products would not be taxable.

MR. COYNE: Entering into the cost of products, the cost of goods?

MR. FLYNN: The cost of goods which ultimately will be taxed. In other words, the intent would be to avoid any duplication of taxes.

THE CHAIRMAN: You do that by exempting producers from all tax.

MR. COYNE: In other words, I suppose, as an administrative device, they would purchase both their goods and service under licence.

MR. HAMER: Under a certificate.

MR. COYNE: So the effect of tax on services will in very large measure fall just on those services which are rendered to individual consumers at a retail level.

MR. FLYNN: Yes.

COMMISSIONER WALLS: You envisage that covering professional men, brokers and real estate operators, do you?

MR. FLYNN: So far as the services enter into the cost of goods, yes.

Is that your understanding, Mr. Hamer?

MR. HAMER: They are exempt from ---

COMMISSIONER WALLS: Otherwise you would make them subject to a services tax?

THE CHAIRMAN: Do you extend this to bank interest and life insurance premiums?

MR. FLYNN: I do not think we would go so far as that.

THE CHAIRMAN: France does.

COMMISSIONER WALLS: France does to financial institutions but not professional services and West Germany does to professional services, but not banks. There is utter confusion if you try to find any common policy with regard to services. That is why I am sure the Commission would be glad if you would give some guidance as to how far you would think it should be extended.

MR. FLYNN: I must say we had not envisaged the bank interest and life insurance interest and that kind of thing.

THE CHAIRMAN: Why not? It is an exceedingly wide base for tax but you are exempting all producers. Why should the consumer not pay tax on the money he borrows?

MR. FLYNN: That is a very good question, Mr. Chairman. Possibly we should think more about that.

COMMISSIONER WALLS: Were you going to ask if it would carry the same rate?

MR. COYNE: I was just going to lead into that question.

What rate of tax do you envisage being applied to services as distinct from goods? Would they bear the same rate or some different kind of rate?

MR. FLYNN: We had visualized the same rate.

MR. COYNE: Reverting to a question which I

asked in another context a little while ago, would you envisage any problem of evasion as far as those persons providing services are concerned where the rate might be at the level of 13 or 15 per cent, or even higher, as Mr. Walls suggests?

MR. FLYNN: I cannot say we considered there would be too much difficulty once the whole scheme had become established.

MR. HAMER: I think we were thinking primarily of the fact that some of the audit procedures which are in force on retail and sales tax in provinces would be extended to this area and picked up in this manner.

MR. COYNE: I suppose you would agree that the policing of a tax on services is probably a great deal more difficult in view of the nature of a service establishment.

MR. HAMER: Yes.

MR. COYNE: More difficult than policing of the sale of goods?

MR. HAMER: Yes, it is.

MR. COYNE: But you have not directed much thinking to this particular matter?

MR. HAMER: Not to the mechanics, no.

MR. COYNE: That is all I was going to ask about services.

THE CHAIRMAN: Can you envisage a sales tax on services imposed by the federal government -- which would have to be at the retail level, I think -- when the federal government was not imposing any other sales taxes at a retail level? Is there any reason

why the government should not impose a tax on services and impose that at a retail level?

MR. FLYNN: I can see no reason why. It would add to the complexity of the tax system, I think, but it should be feasible.

THE CHAIRMAN: Correction difficulties might arise?

MR. FLYNN: Yes.

MR. STYLE: It would justify a lower sales tax on services than on goods.

THE CHAIRMAN: Yes, the usual pattern is a lower rate on services than on goods, though why I am not very clear. Most countries which tax services seem to do so at a lesser rate.

MR. STYLE: Is that because those countries charge a sales tax at the wholesale level on goods and at the retail level on services?

THE CHAIRMAN: No. If they are both at the retail level there is usually a lower tax on services. I do not think they all do that but usually that is the case, and I do not know why.

MR. McDONALD: We have no estimates of yields, but at the moment it would be quite substantial.

I am still worried about the figure mentioned by Mr. Walls.

MR. COYNE: Just turning over two or three pages to paragraph 103, we are now into your section on the existing Excise Tax Act and the recommendations and comments on determining value for tax. Mr. Walls referred to this paragraph a moment ago. Your

recommendation is:

"....that the Excise Tax Act be amended to provide statutory authority for the use of a wholesale price for the purpose of determining sales and excise taxes."

Are you recommending that there be authority to use a wholsesale notional tax base even where an actual wholesale situation does not exist in a particular industry?

MR. McDONALD: Yes.

MR. HAMER: Yes.

MR. FLYNN: Yes.

MR. COYNE: What do you envisage the statute would say? What sort of authority would be introduced into the statute for this purpose?

MR. LANG: There would have to be a definition -- there is no doubt about it -- as to what constitutes wholesale value.

At the present time the Act merely provides that the tax be paid on the wholesale price. In essence, the provision that the Minister operates under now, in which he does give this notional value, would be incorporated into the statute and this would then give manufacturers a right to appeal on the basis of what constitutes a proper value, a wholesale value. At the present time there is no right of appeal.

MR. COYNE: Then as I understand your suggestion, you envisage some very general concept in the statute?

MR. LANG: That is right.

MR. COYNE: And then there would be -- I would infer -- a more extensive regulation but I am still curious as to what you think the statute would say and, secondarily, as to what is the advantage of having the definition, if you like, spelled out in regulations which are a form of law rather than in the statute. Could you expand a little upon how you envisage these concepts as being incorporated into the system?

MR. McDONALD: The objective of course is, so far as possible, to produce the same tax content per unit of product of equal value and utility. So, for the same article produced by two different taxpayers, or two different articles which are competitive and have the same utility but are used by two different taxpayers, the sales tax content in those competitive products, in the hands of the ultimate consumer, should be roughly equal regardless of the marketing methods that are used by the two competitors.

This is the whole background of this problem which is the origin of the unlicensed wholesale procedure. The well known tire case, the Firestone-Goodyear case, was in the area of special brands. It comes up all the time.

The Department has attempted, by allowing discounts, to bring about the reasonable unit equality.

The choice of language is difficult and we have not prepared language but I have stated the intent. I might summarize by saying we have always construed the Excise Tax Act as a manufacturers sales act, although it is not so called.

MR. COYNE: I do not want to interrupt, Mr. McDonald, but I do understand what you describe as being the problem and I also understand, as you describe it, something of the present wholesale branch method which endeavours to arrive at a solution to the problem as you put it forward, that is between two competing manufacturers one selling at the wholesale level and one only selling to the consumer. You are suggesting that this method is not adequate and you want a different method, and I am not sure just what you are suggesting.

MR. McDONALD: We want the same method and we want it liberalized. Let me attempt some language:

> Notwithstanding Section 30, the Governor-in-Council may by regulation empower the Minister to establish a wholesale value which shall be deemed to be the sale price within the meaning of Section 30 of this Act, and such wholesale value shall be determined in order to achieve as nearly as possible equality of the tax content

-- which is an undetermined part --

> in goods sold under competitive conditions which have like value and utility.

MR. COYNE: Now it is becoming clear to me that what you are really suggesting is that the price,

the base upon which the tax shall be imposed, shall be wholly a matter of discretion for the Minister. In other words, he shall determine what the tax base shall be.

MR. McDONALD: Yes, this is what he has been doing for 30 years, and he has been doing so illegally.

MR. COYNE: Perhaps Mr. Lang can answer a question in the affirmitive as to whether you are proposing to increase this to industries where all the competing manufacturers were selling at other than the wholesale level. I understood Mr. Lang to say this was your intent and I do not think this has been possible under the existing system.

MR. LANG: That is right. For instance, a recent case is that of the furniture industry where the Minister had for many years claimed 10 per cent discount from the retail prices as representing the wholesale price in the industry. This has been done away with now so the price in that industry on which tax is paid is the resale price from the manufacturer to the dealer. This sometimes gets involved in respect to the question of imported goods too where furniture may be sold in other countries at the wholesale level and because of imports it comes in under the Customs Act and not the Excise Tax Act and tax is paid on the duty paid value, which is the wholesale price plus duty.

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MR. COYNE: Thank you very much, Mr. Lang. Let me just put this question to you. As I understand the present wholesale branch method, the Minister is prepared, in appropriate circumstances, to allow discounts off all list prices in respect of sales which are made to other than bona fide wholesalers. I also understand that he does that through these regulations on the basis of certain facts about the industry which are available to him. That is, he discovers whether there are in fact stage prices between the different levels in the trade, or whether there are in fact discounts granted at the different levels. If he finds that that is so, he will permit the manufacturer to take advantage of those existing factual discounts, even though he in fact sells to the consumer or the retailer.

The question I want to ask you is this. Under your system, which I understand is completely discretionary, how is the Minister going to determine the sale price? What are the criteria he is going to look to which he does not look to now? How is he to determine what is to be fair and reasonable, if you like, if there is no industry experience to suggest to him what the industry finds fair and reasonable?

MR. McDONALD: There are really two aspects to this, Mr. Chairman. One deals with an entire industry in which there are no sales to wholesalers.

MR. COYNE: Yes. I would be interested in this because I think it is very much an extension of any system which we have had before.

MR. McDONALD: The other aspect of the question

is this. In the case of a manufacturer within an industry who does sell, in part, to the wholesale trade, but who himself does not sell at least 15 per cent of his products in the wholesale trade, so that he is not entitled to a discount, he is therefore now being discriminated against. He will come along and say: "Will you revise the regulations so that I may go to the Minister and say that I too am entitled to a discount?"

That is the easy part of the question to answer and we would not be too hard pressed for support for this submission.

With reference to the first part of the question, I am not prepared to answer that. Where you have an entire industry in which no sales are made at wholesale, I would say that a different test or criterion should be suggested, and that is this. The purpose of the manufacturers sales tax is to impose a sales tax on the manufacturers cost and profit, but not upon his costs and profit on marketing and distribution. This is the theoretical concept which has been lurking in the background for many years. If you have an entire industry which distributes direct to the retail trade, and that industry competes with another industry -- let us say it is in building materials and it produces wall-board made from wood products, which is competing with plastic or metal sidings for walls, and in the metal wall industry there are representative wholesale sales made but that in the fibre board industry there are none, but they are made direct to the retailers, then you have there inter-industry competition and there is a case for

relief. But the case is somewhat different. You look to the inter-company competition with reference to tax content and end products and then you also look to the inter-industry competition with reference to products which compete and have the same utility and use.

MR. COYNE: I suppose that this introduces enormous complexities in the determination of sales prices from an administrative point of view.

MR. McDONALD: I doubt whether they would be any more complex than the present considerations.

MR. COYNE: Except that the present considerations are surely based on an analysis of the facts existing in a particular industry -- that is, the marketing techniques, discount taxes and levels of prices.

MR. McDONALD: The administration can look to a wholesale price under the present circumstances.

MR. COYNE: All they would have to say, in effect, is that Manufacturer B may use Manufacturer A's wholesale price, not having got one himself. That is relatively straight forward and simple.

MR. McDONALD: With regard to this aspect of your question we think that the problem is difficult but not insoluble. In our recommendation in paragraph 112 we provide for a right of appeal -- I am now anticipating your question here -- which is basically an administrative appeal not dissimilar to the Board of Review procedure under the Australian income tax law, but without the rules of law concerning appellant procedure.

THE CHAIRMAN: Before we go on to that, so that

I may understand your question could I bring this question down to the facts of a particular circumstance. I do not understand when one industry competes against a different industry, because I think that practically every industry is competing against every other industry and trying to entice the consumer's dollar. Let us take, on the one hand, automobiles, and on the other hand gramophones. I would suggest that they compete against each other. The consumer has to make a choice. I think the discount permitted automobiles is very low, because I think the tax is assessed at the price at which they go to the dealer, whereas I think gramophones are quite different. The amount of tax, therefore, on automobiles is a higher proportion of the money which is spent on cars than it is on the money spent on gramophones. Do you happen to know if I am right here?

MR. McDONALD: I do not know whether you are right concerning that specific example, sir, but I can say ---

THE CHAIRMAN: Well, would you assume that I am correct. How would you proceed on the system you propose to straighten the matter out?

MR. McDONALD: We do not attempt to solve that problem at all. The discrimination to which our attention has been directed concerns differentials in tax content with reference to competitive goods, either like goods which are competitive, or goods of equal or similar utility. But not goods which have a different utility and merely compete generally in the market.

THE CHAIRMAN: You are not concerned with the

washing machine competing against the stove?

MR. McDONALD: No.

MR. COYNE: Surely your recommendation would affect the automobile manufacturer by its very generality. As a matter of fact, as I read this recommendation, automobiles would bear substantially less tax than heretofore because the Minister would be bound to determine what the notional price to wholesalers of automobiles would be if there were any wholesalers of automobiles.

MR. McDONALD: With respect, Mr. Coyne, I would disagree with that. In the automobile industry I think it is reasonable to assume that the total amount received by the manufacturer for his product is the manufacturer's gross profit. The marketing effort, except for warranty and national brand advertising, is the effort of the dealer.

MR. COYNE: Perhaps my example there is not an apt one, and I do not know much about the automobile industry. But you are suggesting to the Chairman that your recommendations do not extend to those industries which do not suffer in some sense from a competitive disadvantage from having the sales tax levied at the higher level than would be the notional wholesale price that you are speaking of. Whereas I read your recommendation as being of general application and requiring the Minister to determine the notional wholesale price in any industry.

MR. LANG: Quite frankly, this does get to a difficult stage. Our purpose here was to give the

right to any industry to ask for a wholesale price and to make its representations to the Minister based on the statute, by arguing that in fact they are doing a wholesale job of distribution, and what, in essence, that would mean in respect of a reduction in price from a dealer.

THE CHAIRMAN: So that if there were no wholesalers in an industry, it would give the dealers a right to say that, there being no wholesalers, the price on which the tax should be assessed is on the national wholesale price which the Minister would have to establish. Is that correct?

MR. LANG: Right. It would be based on the facts in each individual industry as to what that would amount to. In some cases it might only be 5 per cent. In some cases it might be 20 per cent.

THE CHAIRMAN: I am still worried about automobiles, because as far as I know there are no wholesalers. Therefore one has to dream up what a wholesaler would do if there were wholesalers.

MR. LANG: That is right.

MR. COYNE: If we can move on now to this right of appeal matter which you refer to in paragraph 112, your recommendation is:

> "That there be a right of appeal to the Tariff Board from a determination of the sale price on the ground that the said price was not fair and reasonable having regard to the marketing

methods generally employed by
the appellant".

My first question, or perhaps it is an assumption, is that the law which says what the sales price shall be for tax purposes is that the price shall be such as is fair and reasonable having regard to the marketing methods generally employed by the appellant. In other words, that is what your definition is of what the sale price should be.

MR. McDONALD: Coupled with the suggested languaged stated earlier, which would outline in general terms the basic ---

MR. COYNE: You mean, you would define "fair and reasonable"?

MR. McDONALD: That is right.

MR. COYNE: But if you have this discretionary power in the Minister, under which he is directed merely to arrive at some point which is fair and reasonable, then what point is there in having the right of appeal given to somebody else to express his opinion as to what is fair and reasonable? In other words, if it is an arbitrary discretion in any event, why do you have to go from one body which may come up with an opinion you do not like to another body which may come up with an opinion you do not like?

MR. McDONALD: It is the old story of the French admiral who was guillotined for losing a battle to the English, and in reply to the question why the dreadful deed was done, the French government said: "This is to encourage our other admirals". Although this

right of appeal will seldom be used, it will have a disciplinary effect on the Department.

MR. COYNE: Well, it is totally unlike any other right of appeal which has been suggested before. I also want to ask you this. Is it appropriate to place this type of jurisdiction in the Tariff Board, which in regard to its other duties is concerned solely with questions of fact and interpretation, not of opinion? Why pick the Tariff Board for this sort of appeal on a question of opinion?

MR. McDONALD: For lack of a better choice.

COMMISSIONER PERRY: Might I ask, Mr. Chairman, if it was visualized that the present mechanism for giving the concession or adjustment would be retained? That is, the discount rate set for a whole industry. Would not the people who would be appealing be those who felt that this was not appropriate in their case?

MR. McDONALD: Yes, sir.

COMMISSIONER PERRY: So that the ministerial discretion is to set a rate for a whole industry. That is how it would work in practice.

MR. McDONALD: Also for a particular taxpayer.

COMMISSIONER PERRY: Would the Minister go out and proceed to set up rates for every individual taxpayer in the business?

MR. McDONALD: Where there is a marked differential between the rates which a taxpayer ---

COMMISSIONER PERRY: But he would do that?

MR. McDONALD: Yes, and it has been done in

practice for many years. The only difficulty, and I emphasize it, has been that if the taxpayer is not satisfied with the wholesale value established under the circular, the discount allowed him from the sales end-user price, he has no remedy. The law provides that sales tax is imposed on the sale price.

COMMISSIONER PERRY: I think we are at cross purposes here. I realize that there are different discount rates set for different industries, but I did not realize that different discount rates were set within an industry.

MR. McDONALD: Yes, very much so.

COMMISSIONER WALLS: I think that what you say about this having a governing effect, without there being too many cases, has been proven true both in the United Kingdom and in Australia, where they have a Commissioner of Taxation who also looks after income tax, at least in one case. His rulings can then be taken to a Board of Review, and in both countries the number of cases which have been taken to the Board of Review has been remarkably small.

MR. COYNE: Just one other question on this right of appeal section. It really arises out of paragraph 114 and has to do with the procedure which you envisage. You say in that paragraph:

"The type of procedure envisaged by the Association would be one in which the appellant and any respondents to the Notice of Hearing would each be entitled to

adduce his own evidence in camera
before the Board".

Who would be respondents to a Notice of Hearing in an appeal of this nature?

MR. McDONALD: Typically the competitors ---

MR. COYNE: Excuse me, Mr. McDonald, but I should couple that question with these two subsidiary questions. Would the notice be published, and what would the notice say?

MR. McDONALD: It would be not dissimilar to the notice used in the Eaton case under section 57 of the Act. It would simply inform the public through the Canada Gazette that Company X had filed an appeal concerning determination of the wholesale value of its goods for the purposes of the Excise Tax Act.

MR. COYNE: That is goods?

MR. McDONALD: That is goods and nothing more.

MR. COYNE: Then who would respond to that sort of Notice of Appeal? Surely no one else, no other company, would take any interest in that appeal?

MR. McDONALD: I think they would, Mr. Coyne. They certainly have in many cases with which I have been connected.

MR. COYNE: Yes, but here the evidence is to be introduced in camera. In other words, a respondent would have no knowledge as to what the case was that the appellant was putting forward, so how could he answer it?

MR. McDONALD: It depends on the circumstances of a particular case. In some industries it is possible to reconstruct from shopping competition what the tax

content in the end product is likely to be within a margin of 5 per cent. This is true in highly competitive industries where pricing is very close. It is possible to make a reconstruction. Admittedly, there would be much fewer respondents to this recommendation than under an open hearing. In the Eaton case, for example, there were some 17 respondents.

MR. COYNE: Of course, but in that case each heard each other's case and were able to cross-examine the other's witnesses and put in their own evidence, whereas here I do not see how anyone could answer a case when he does not know what the case is about, or does not hear the evidence.

MR. McDONALD: The majority of those respondents did not adduce evidence.

MR. COYNE: I do not see how the tribunal or the Board could relate any cases which might be put in in the absence of any knowledge of the other fellow's case.

MR. McDONALD: This might turn out in practice to be a very valid point, but if it transpired that there were no response and the only person who appeared was the appellant himself, the Tariff Board might then find that it had inadequate information. However, we must bear in mind that the Department of National Revenue certainly will be the respondents and the officials of the Department will be available to answer questions concerning treatment of other taxpayers in the industry without that information being imparted to the appellant.

MR. COYNE: Although, I suppose, if it were a

hearing at which only the appellant and a national revenue man were appearing, there would not be the same need for the in camera feature of the proceedings, except to the extent that National Revenue might want to introduce evidence relating to somebody else's business other than that of the appellant.

MR. McDONALD: Yes. That comes to the heart of our recommendation and is well stated.

MR. COYNE: I have nothing further on this apsect of the matter, Mr. Chairman.

THE CHAIRMAN: What time would you like to break off for lunch, Mr. Crabtree?

MR. CRABTREE: This is a matter entirely for you, sir.

THE CHAIRMAN: We usually go close to 1:00 o'clock. It is about twenty minutes to now.

MR. COYNE: Then I will proceed. I should like to go on for a moment to your recommendation in paragraph 111, page 40 of the brief. This deals with the point Mr. Walls referred to about you recommending that excise duties payable under the Excise Tax Act be excluded from the price at which sales and excise tax is computed.

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I take it that this is purely a technical adjustment, is it? We are only talking about tobacco and liquor?

MR. McDONALD: That is right.

MR. COYNE: If the government, as a matter of policy, determines that liquor and tobacco shall bear a certain amount of tax, does it really matter very much whether they get it in the form of excise duty or excise tax?

MR. McDONALD: Only that the Association objects to the hidden feature under this Act.

MR. COYNE: You are not recommending that the taxes on liquor and tobacco be reduced?

MR. McDONALD: No. If the government's policy is to collect so many dollars per gallon of spirits, let it collect so many dollars per gallon of spirits as excise duty.

MR. COYNE: That is why I was suggesting that this is really just a technical adjustment.

MR. McDONALD: Yes, it is; but it is an element of tax on tax, is it not?

MR. COYNE: As a matter of mechanics, at the present time, yes. Turning to your section on double taxation ---

THE CHAIRMAN: I have one or two questions before we leave this subject. I am interested to see that you recommend that: "General rulings, interpretations and intentions should be made known promptly through some medium of publication that would be readily available to taxpayers." Then you recommend: "That all general valuation agreements be published in the

'Canada Gazette', and that general rulings, interpretations or intentions be published immediately they are issued". I think the Department is involved in a huge volume of correspondence with taxpayers as to whether a certain article is deemed to come within a certain section or not, and I would think, from what you say, that you believe all replies to that kind of correspondence could properly be put in the form of a ruling or some kind of a statement which may be published. Am I correct?

MR. McDONALD: Yes.

COMMISSIONER WALLS: Would you not go further than the mere publishing in the "Canada Gazette"? I am thinking of the method employed in regard to the Customs Tariff, where those who are interested pay a certain fee and receive a looseleaf binder and then each month, or periodically, receive all the rulings. I believe that practice is carried out in most other countries. For instance, in Australia they receive monthly all the rulings that were made during the previous month.

MR. McDONALD: In fairness to the administration, I believe that Mr. Lang will confirm that the communication of departmental decisions to the public has improved in the past three or four years. This recommendation goes back several years in C.M.A. submissions to the Minister of Finance. When it was originally introduced there was high degree of secrecy, which extended to even general decisions. It was not impossible to learn what they were, if one had a representative who called into Ottawa monthly and had a chat with the officials, but under the current practice there are still some

decisions which are not published, or are not published quickly enough.

COMMISSIONER WALLS: Even where they are published, are they not only submitted to the people in a like line of business, whereas a tax ruling on one line of business could have a bearing on representations to be made with regard to an entirely different type of business?

MR. McDONALD: It often does, where there are related products in different industries.

THE CHAIRMAN: All right, Mr. Coyne.

MR. COYNE: In the next section on double taxation, in paragraph 122, you sum up two recommendations. Firstly, that the sales tax on production machinery and apparatus and parts therefor be repealed; and secondly, that all articles and materials which enter into the cost of manufacture or production of goods be exempted from sales tax.

I just wanted to ask whether this second recommendation looks to the elimination of double taxation which has always existed as, for example, with transportation and distribution equipment, office equipment and supplies; or do you envisage that such articles would continue to be excluded from the exemption?

MR. LANG: We envisage that an exemption be limited to those articles and materials which are actually used in a factory; in other words, factory premises.

As it is now, the Minister exercises his

discretion in determining whether machinery and apparatus is used directly in the production of goods, and this question of what is used directly is, we feel, much broader and is better able to be administered with regard to all articles which are actually used by a manufacturer in his production.

COMMISSIONER WALLS: Is it not a fact that most processing materials are exempt today, and is it not better that they should be listed as they are, under each particular industry?

MR. LANG: Processing materials are one of them, but the production machinery and apparatus, of course, is the one which ---

COMMISSIONER WALLS: I was dealing with the second recommendation. The first is dealing with production machinery and apparatus, and the second is dealing with articles and materials which enter into the cost of manufacture. It would seem to me that is already taken care of.

MR. LANG: No. We are thinking here, for instance, of air-conditioning equipment in a factory, fire extinguishers, fire fighting equipment. These items are now taxable even though they are used in a factory, but they are not used directly in the production of goods. These are the items with regard to which we really advocate this.

MR. COYNE: Is your point, principally, eliminating the discretion of the Minister? We are talking in terms of the production machinery exemption as it existed up until last June. Is your objection

to the discretion in the Minister, or to the word "directly" in connection with production and manufacture?

MR. LANG: It is the use of the word "directly". It is easier to figure out what is used in the cost of producing goods than it is "directly used in production".

COMMISSIONER WALLS: That is another $140 million that they have to find. The 11 per cent tax on production machinery will come to $140 million. That is an estimation. You are going to do away with that, so this $140 million has to be found somewhere else.

MR. McDONALD: Perhaps, sir, with the increased work that will arise from these amendments and services rendered by the accounting profession, it will help to close the gap.

MR. COYNE: The last part of this section is concerned with special excise taxes. I have two or three questions which we might perhaps continue with, Mr. Chairman.

THE CHAIRMAN: Go ahead, Mr. Coyne.

MR. COYNE: Dealing with special excise taxes, you recommend that the special excise taxes imposed under the Excise Tax Act be repealed, and then you say:

> "In the view of the Association there should be no permanent place in the federal taxation structure for such special levies."

My first question is to make sure we are talking about the same thing, because special excise

taxes in fact generate $260 million of revenue, according to your table on page 6.

Of course, the vast bulk of those taxes are imposed on tobacco products and wine, and a relatively small amount of money is churned up by these "nuisance" taxes.

COMMISSIONER WALLS: I think perhaps you are getting excise taxes and excise duties mixed up. I think the largest percentage of excise tax revenue comes from T.V.'s and radios, rather than tobacco.

MR. COYNE: I beg your pardon. Anyway, it is $260 million, according to your figures on page 6. Perhaps you could say why you think there should not be the special excise taxes which generate this enormous amount of money, because obviously $260 million, if it is not paid on these products, is going to be paid on other products.

MR. LANG: I think that generally speaking the argument here is that the selection of certain commodities for special excise taxes discriminates between different commodities. We feel, really, that the whole special excise taxes under Schedule I of the Excise Tax Act could be repealed, and if there are any items in there which the government feels should be particularly selected for a special assessment, they should be put in under excise duties. This would simplify the whole sales tax structure.

MR. COYNE: Then you are not objecting to their being a permanent place in the federal excise tax structure for special levies on special goods?

MR. LANG: No; but these were imposed, as you will recall, back in the days of the foreign exchange difficulties, and were justified primarily to discourage consumption, and in essence they just continued in effect. Most of them have been repealed, and the last was the special excise tax on automobiles.

We feel that the "take" will go down in future on these items, but it is time ---

MR. COYNE: I wonder if we are talking about the same thing, because, with respect to Mr. Walls, in section 1 it covers phonographs, t.v.'s and the largest items; but Section 2 deals with cigarettes and tobacco, with the rate of about 20 cents a package for cigarettes. I think that the $260 million, or the major bulk of that amount, comes out of excise taxes on cigarettes and tobacco.

MR. LANG: Yes, we are talking about Schedule I, really.

COMMISSIONER WALLS: Of course, your argument with regard to the section dealing with tobaccos under the Excise Tax Act is that this could very well be changed over to excise duties?

MR. LANG: That is right.

COMMISSIONER WALLS: Therefore, as far as that one section is concerned, it could all be put in there, and the tax increased; I think that is the point you are bringing out.

MR. LANG: The consolidation, elimination, simplification of the ---

MR. COYNE: Of the Excise Tax Act?

MR. LANG: Yes.

MR. COYNE: In other words, getting these special things out of the Excise Tax Act and into some other taxing statute such as, for example, the Excise Act?

MR. LANG: Yes.

COMMISSIONER WALLS: What do you do about radios and t.v.'s, where that tax was supposed to have contributed towards the cost of t he C.B.C.?

THE CHAIRMAN: And could be said to go there, could it not?

MR. COYNE: Yes, it is earmarked.

COMMISSIONER PERRY: Not any more.

THE CHAIRMAN: Whether or not it is earmarked, that is where it goes.

COMMISSIONER PERRY: I would like to point out that we have had some excise taxes of some sort or other since 1916, when the special revenue act in this connection was passed. They are of much greater advantage than is suggested here. That does not make them any better, and I am not putting that forward as a defence.

COMMISSIONER WALLS: I would like to get your reaction to this. A great many other countries in the world use a graduated tax rate at various levels, depending on where they carry the tax. Some of them have as many as seven different rates, which I think is too many; but others have two or three tax rates. So you could combine your Excise Tax Act with your sales tax and have a graduated scale at either two or three

levels. Have you given any thought to that as an alternative?

MR. LANG: That would be one solution to it.

THE CHAIRMAN: That is merely a tidying up process, though?

MR. LANG: Yes, simplification.

COMMISSIONER WALLS: It saves the revenue; that is what I was thinking.

THE CHAIRMAN: I think we will stand over now until 2:15. Mr. Flynn, do your sales tax people propose to return after lunch?

MR. FLYNN: I am afraid not, Mr. Chairman.

THE CHAIRMAN: Then we have one more question before we break off.

COMMISSIONER WALLS: It is your submission, which I think is quite justifiable,that today a vendor is held responsible for any incorrect exemption certificate made out by a purchaser. I was wondering what you thought of the alternative that is used in Australia, where the purchaser makes his statement to the Crown and not to the vendor, and therefore the responsibility is placed on the crown of directly charging the purchaser instead of placing the responsibility on the vendor.

MR. McDONALD: This we entirely support. National Revenue in Canada have effected a policy, which they still follow, of refusing to accept what they call third party certificates; they put the onus, the burden, on the manufacturer. In the furnace humidifier case -- I have forgotten the name of it -- which is set out in

the brief, I am informed it is going to the Supreme Court of Canada. Notice of Appeal was filed recently, I understand. The C.M.A. feels very strongly about this point. The law makes the manufacturer a policeman, and if a mistake is made it makes him the guarantor of the tax, when the wrongdoing is done by a third party.

COMMISSIONER WALLS: The Act does not, I believe, provide any very adequate penalties either, does it?

MR. McDONALD: The Appellant in the humidifier case was subjected to very heavy penalty interests. I have forgotten the rate, but I think it runs as high as 12 per cent.

MR. COYNE: Is the penalty not the burden of having to pay the tax years after the opportunity to collect it from the customer has passed?

MR. McDONALD: Yes, it is penalty interest.

COMMISSIONER WALLS: What about the penalty for misrepresentation; should not there be an additional penalty in a case like that, rather than only having to pay the back tax if you are caught?

MR. McDONALD: The manufacturer, in many cases, simply cannot confirm that the end use of the product is as represented by the purchaser. It is impossible to do so. We simply feel that the party who is in effect paying the tax, committing a fraud on the Revenue, should be made responsible, and that the innocent manufacturer -- who is the ham in the sandwich -- should not be provided to pay the tax of the wrongdoer.

THE CHAIRMAN: We will now stand over. After

the adjournment we will come back to the remaining matters here, which might take us until half past three or thereabouts.

---Luncheon adjournment.

---On commencing at 2:30 o'clock p.m.

THE CHAIRMAN: Mr. Coyne, from where do we proceed now? Page 14?

MR. COYNE: Page 14, I think, is where we left off.

Mr. Flynn, this is the section that gets into tax incentives. In paragraph 31, towards the bottom of the page you make one or two general statements. You say:

"While each tax incentive is designed to promote a public need and undoubtedly benefits individual industries, it would be harmful to regard any or all of them as substitutes for a needed reduction in corporation tax rates. While it must be recognized that the establishment of tax incentives is more likely to receive public acceptance and approval than reduction in corporation tax rates, nevertheless, their usefulness is often impaired by serious disadvantages."

Then at the beginning of the next sentence you say:

"They introduce discrimination in favour of some companies and against perhaps equally deserving companies which through no fault of their own are not able to bring

themselves within the condition of the tax incentive."

Would you agree that any tax incentive, is, by its very nature, discriminatory, that it is intended to be discriminatory?

MR. FLYNN: Well, Mr. Coyne, it is intended I would say to promote a particular objective ,and in so doing it may be that some element of discrimination will get into it. But I think we can draw a line between some of these incentives, for instance the scientific research one where there is an element of discrimination in the application of that incentive as between different companies due to the base, etc. But on the whole, the objective of promoting greater research in Canada I think is sound, but in the application of it discrimination has crept in.

MR. COYNE: Yes, I take your point but I was really thinking in more general terms and putting to you this proposition, that any tax incentive which grants relief to some taxpayer or some class of taxpayer is by its very nature discriminatory in the sense that it means that you and I as ordinary taxpayers pay more taxes.

MR. FLYNN: That is correct.

MR. COYNE: We are not entitled to this special relief or incentive.

MR. FLYNN: That is correct. I think that is why we feel that the less emphasis placed on incentives which can by their nature be discriminatory, the better, and the better purpose would be served by

lowering the overall tax rate which would apply to all taxpayers.

Would you care to add anything to that, Mr. Willmot?

MR. WILLMOT: I do not think I can add much to it, Mr. Flynn. I think your point is very well taken.

I think by and large our Association feels that these incentives are a little more sensational than effective. Publicity is given to them at the time, but by and large the forces of economics dictate whether you can take advantage of some of these things, and I think in terms of stimulation to industrial activity, re-employment of funds, reinvestment of funds and so on, the Association's view is that it is not as effective as perhaps the public by and large might feel is the case. I suggest perhaps that some members of your Commission would know that as well, sir.

MR. COYNE: Although you do feel that some are more effective than others?

MR. WILLMOT: Yes. We have dealt with capital cost allowances a little differently. I feel we think in that area there is more effective result, and perhaps it is a little less discriminatory. We say it is not as discriminatory as some of the others and perhaps a little more effective.

MR. COYNE: Does the Association take the view that there is any basic objection to discrimination in the sense in which we are using it here? I mean if a tax incentive is designed to persuade someone to do what he would not otherwise do, is an incentive which

has that object in view necessarily a bad thing, generally speaking?

MR. WILLMOT: I think our view more generally is in some measure if some relief on the corporate rate were given we think it probably would have a better effect on the economy than trying to do it through incentives.

THE CHAIRMAN: I suppose you would have the same concern that I would have, namely that the cost of some of these incentives may be very substantial -- and I think is. It is not tabulated and one cannot tell what the cost is, it is a hidden cost, and whether the country obtains benefit in proportion to the cost is almost impossible, as far as I am aware, to determine. It could well be that we pay much more money by tax concessions than is ever paid off in advantages for the economy.

I can think of these tax equalization reserves, if you like, on balance sheets, which you may not even call tax incentives, but it is the difference of depreciation taken on a measure of income and capital cost allowances in the books. I can think of one now that has $44 million and which will become $100 million in ten years. It is going to be reversed, but what is it going to cost the government in interest on that money that they would otherwise have? It is certainly $5 million a year and I think that is a lot of money. If that is multiplied many times, it is truly costly.

MR. FLYNN: Do you consider that a tax incentive as such? That is merely the relationship of

the reducing balance method of capital cost allowance to straight line depreciation.

THE CHAIRMAN: One method of measuring income beyond what you would say is the best measurement of income must be for a purpose. I think the purpose is possibly to encourage expenditure in that case, but I do not know because I was not there when it was designed. It is a concession beyond the measurement of income; is that not right?

MR. FLYNN: Yes. We have not actually included that under the heading of tax incentives.

THE CHAIRMAN: No, I was taking the most conservative position I could. Going on to other things, the small amounts of which I am speaking then become truly monumental.

MR. STYLE: On this question of discrimination I think it is to some extent a matter of degree. The Association, for instance, have considered tax incentives on exports. A tax incentive on exports would be discriminatory against those companies dealing mostly in domestic commodities, and to a large degree.

THE CHAIRMAN: Most tax concessions, as Mr. Coyne says, must be discriminatory against people who do not get them because they shift the tax burden. You point out it is against local profits. That is quite correct, but you must also have regard to the fact that a great many of the incentives are some kind of allowances applied to capital formation. If you like, that is discriminatory against the type of businesses which do not require the same amount of capital. I

think it must be pretty clear that this falls very unevenly.

MR. FLYNN: I think our feeling, Mr. Chairman, is that incentives are desirable but there should be as little discrimination as possible. I think that is our broad thinking on the subject.

MR. COYNE: Picking up perhaps rather briefly some of the individual incentives you comment upon, your comments are by and large quite clear. The first is the point with regard to the increase of accelerated depreciation, and you say it is all manufacturers.

The Chairman has just pointed out that the existing capital cost allowance system is a system of accelerated depreciation, if you like, but I take it you are suggesting in this paragraph 34 that there should be some additional acceleration permitted over and above what is available to everyone now.

MR. FLYNN: I think here the suggestion is that accelerated depreciation should not be granted to some industries for some specific purposes and not to others. If there is to be accelerated depreciation, it should be across the board.

MR. COYNE: This is getting back to the point Mr. Willmot made a moment ago. Your basic position is that there should be a general reduction of general tax rates rather than the picking and choosing which is involved in incentives.

MR. FLYNN: Yes.

MR. COYNE: Then your next suggestion relates to investment allowances.

MR. FLYNN: Yes.

MR. COYNE: And you recommend that investment allowances be established in Canada at rates comparable to those in the United Kingdom, which are now at the rate of 30 per cent on machinery and equipment and 15 per cent on new buildings.

MR. FLYNN: Yes.

MR. COYNE: Perhaps this is repetitive, but is this type of recommendation made independently of the corporate tax rate that we may have? In other words, are you suggesting there should be both lower corporate taxes and investment allowances and these other generalized incentives as well, or are you thinking in terms of alternatives?

MR. FLYNN: I think in this case we are thinking more of alternatives because if there were a general reduction in the corporate tax rate I do not think there would be the clamouring for additional incentives.

I think investment loans are in a slightly different category in that recovery through depreciation of more than costs is recognized. You get up to 130 per cent or 115 per cent, as used as examples here. In effect a company is then able to recover more than the cost of the original installation and go some way toward offsetting the inevitable erosion of costs and so on through rising prices.

THE CHAIRMAN: It is an anti-inflation method you are recommending?

MR. FLYNN: Partially.

THE CHAIRMAN: What merit has it beyond that?

I fail to see it. It was introduced in the United Kingdom as a means of achieving economic stability in order that when capital expenditure was thought to be a good idea it could be increased and when it was thought contrary-wise it could be reduced. But unfortunately it is not very easy to reduce it and the manufacturers in the United Kingdom say to the government now they have this, "We require assurance that you are not going to change the rates". In other words, they knock it out completely as a stabilizer. It is now, I suppose, a growth provision if it is at all useful. I can understand your argument as an anti-inflationary measure, but I cannot see what it does for you beyond that.

MR. FLYNN: I think it is, Mr. Chairman, an incentive for greater capital expenditures in the private sector and with a view to increasing the possibilities of employment in this country.

Would you care to add anything to that, Mr. Style?

MR. STYLE: No. I am not quite sure how it would increase employment. It would tend to increase the speed with which you replaced your assets for more up-to-date assets, and to that extent more competitive I suppose.

THE CHAIRMAN: To the successful company it operates as a subsidy. To the unsuccessful, it does not.

COMMISSIONER WALLS: I note that you say you think that it contributed substantially to the post-war expansion of industry in the United Kingdom, the 130 or 115 per cent depreciation, but with the exception of Holland who

has 110 per cent, all the European Economic Community countries and Sweden are on the same basis as Canada, and yet surely the economic expansion was just as great in France and Germany as it was in the United Kingdom without the benefit of this.

MR. FLYNN: Would that be because of the different conditions in the country?

COMMISSIONER WALLS: Could there not be equally different conditions between Canada and the United Kingdom?

MR. FLYNN: We did not need it in the immediate post-war period up to 1955 or 1956, possibly. I think our thinking here is that it would be a stimulus for further investment.

THE CHAIRMAN: Yes, but would not a better stimulant be to reduce taxes?

MR. FLYNN: Definitely.

MR. STYLE: Yes.

MR. FLYNN: Yes.

THE CHAIRMAN: And a much fairer approach, I think.

MR. FLYNN: I think, as Mr. Coyne said, this was put in as an alternative to a reduction in tax and I think the answer to that again is that a reduction in tax is the best, and if that cannot be achieved then possibly some of these things might be introduced.

MR. PERRY: Do you have any choice between the British system, which is a deduction from income, and the American system, which is a tax credit, assuming they can be set to produce the same results? I am

wondering if there are any other considerations which would lead one to choose one rather than another.

MR. FLYNN: I am not in a position to answer. The American system is something like the system we had immediately prior to the war. Ours was a 10 per cent rebate on capital expenditure and the American is 7 per cent.

COMMISSIONER PERRY: It might have the minor compensation of not distorting the income situation.

THE CHAIRMAN: And it is more measurable in total.

MR. FLYNN: Again, it is a direct subsidy.

COMMISSIONER PERRY: It is just a matter of form. The effect is the same excepting on the income computation.

Just for the record, I think it should be said that the main stimulus to investment in continental Europe after the war was the revaluation of assets to post-war prices. This was an enormous free gift to industry which was immediately applied toward the acquisition of new assets. It was far more valuable than an investment allowance.

THE CHAIRMAN: And, of course, they have had a pretty massive degree of inflation.

MR. FLYNN: That is a situation that has not been accepted on this side of the Atlantic.

THE CHAIRMAN: I think most people would agree that the necessity for it on this continent is not as great as it was in Europe.

MR. COYNE: The next incentive you deal with

is the scientific research incentive, and you make several specific recommendations. The first of these recommendations appears in paragraph 41 on page 17, where you recommend that the taxpayers have the option of taking as a base period not just the single year ending before April 11, 1962 but an average of the last three or four or five years ending before that date. My question is just a simple one for clarification. It was not clear to me whether you were suggesting three options or two. In other words, are you suggesting he have the option of the single year or a three year average or a five year average, or are you suggesting he have the option of a single year and an average which might be either three or five years? You are not suggesting one or the other?

MR. FLYNN: I think it is three or five we are suggesting:

> "...the taxpayer should have the option of taking as a base period for the tax incentive a base period consisting of the average of research expenditure in the last three or five taxation years ending before April 11, 1962, instead of the prescribed loss taxation year of the corporation ending before April 11, 1962".

In other words, either three or five.

MR. COYNE: And you are not expressing any preference as between three or five?

MR. FLYNN: No.

MR. COYNE: It seems to you that either would be reasonable?

MR. FLYNN: Either would be reasonable and I would imagine the five year period would be the most equitable.

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MR. COYNE: Your second recommendation, which appears in Paragraph 43, is that research expenditures for both base period and current purposes should be separated into current expenditures and capital expenditures, or, alternatively, that capital expenditures might be excluded from the base altogether. You say in Paragraph 44:

"A company which has spent an unusually large amount of money on capital expenditures for research purposes during the base year will, if current and capital expenditures are to be lumped together for the purposes of the incentive, have little incentive to increase current research expenditures".

I should just like to make a comment on that statement in this light. At least, I would put it to you that if a company has expended large sums on capital equipment during the base year, he is not liable to leave that capital equipment lying idle. Surely having made this expenditure he is committed to increase his current expenditures, and there is no need to provide him with an tax incentive.

MR. FLYNN: You are suggesting that merely because he had expanded his research facilities before this section was introduced, he should not benefit. Is that it?

MR. COYNE: Yes, that is what I am

putting to you.

MR. FLYNN: Well, I think that is one of the things we probably most object to. The ungodly are being favoured while the righteous are penalized!

MR. COYNE: Well, I am very impressed with your spirit of generosity, Mr. Flynn, but both you and I are the taxpayers paying off this ungodliness. If the tax incentive is designed to persuade somebody to do what he otherwise would not have done, which is surely the only ground on which a tax incentive can be justified, then why hand it out to somebody already committed to doing what you want him to do?

MR. FLYNN: This is one of those cases where you get into discrimination.

MR. STYLE: Probably it is the highest form of discrimination.

MR. FLYNN: Yes, it is.

MR. COYNE: Well, I think the point is clear.

COMMISSIONER PERRY: It seems you are giving everyone an incentive to invest money.

MR. COYNE: In any event, you are saying, in effect, and your third recommendation makes it clear, that anyone who spends money on scientific research should get special tax relief.

MR. FLYNN: The basic objective of this is to encourage everybody to get research work done in Canada instead of buying it from

outside. I am referring to work which has not been done before. Unfortunately, some companies have done this, although not too many, and they will be at a disadvantage opposite those people who will take advantage of these incentives and get into competition with them. That is apart from the Government money.

MR. COYNE: What disadvantage?

MR. FLYNN: They are getting the tax benefit that established researchers are not getting.

THE CHAIRMAN: That is a disadvantage vis-a-vis the others, but not vis-a-vis what the position would have been if there had been no change in the law.

MR. FLYNN: Yes. But the law has introduced this discrimination. Do you care to add anything, Mr. Willmot?

MR. WILLMOT: I must apologize because I am really not informed about this matter, but I have the feeling that the size of Canadian industry and the size of Canada itself is such as to make basic research rather difficult for most companies. I do not know whether people who are assisting you in any way may have done any research into the possible expansion of this provision so as to encourage more research work to be done, but perhaps there may be a definition which would be somewhat less restrictive than scientific research. It is very difficult for

most Canadian companies, owing to the nature of their size, to do basic research.

While I am not touching particularly on Mr. Flynn's point, I would suggest that there may be some area for consideration here because of Canada's size. You all appreciate, gentlemen, that by and large there is not very much basic scientific research being done in Canada, yet we must encourage it. I think it is encouraging and perhaps what you have already done, or what has been done already in Canada, is encouraging companies of parent firms outside of Canada to do more research in Canada. I think there have been moves along this line. I think of companies in Canada without foreign ownership who might be encouraged to do more work along these lines somewhat within a broader interpretation of what is meant by research. It is a hazy area I am talking about. Perhaps I am talking a little more of the philosophy of the treatment of the legislation than the practical aspect, but size makes it very difficult for most Canadian companies to be involved in research.

THE CHAIRMAN: I think, Mr. Willmot, that we accept that this is so. It has been said many times that this has attracted more research into Canada.

MR. WILLMOT: Yes, I think so.

THE CHAIRMAN: And probably you would support that contention by saying that all incentives

contribute to this sort of thing. But there are still problems which you and I, as individual taxpayers, have to meet out of our pocket. Because that is what we are doing. The people who formerly did not do research will now do it, but do we want to pay even more money out of our pocket to everybody even though they did not do research before? Do we want to make people come to Canada to do research, or to pay compensation to everybody in Canada for the research that they are doing? You are saying that you and I as individuals should not restrict our payment to those people who were formerly not doing research but will do so in the future. We are to make those payments to everyone. Think of it in light of the payments being made out of your own pocket, because that is exactly what, in the final analysis, it is.

MR. COYNE: These are not the write-offs of 100 per cent of the expenditure which everyone gets anyway. This is the extra 50 per cent, the subsidy if you like, which is involved in Section 72A.

MR. TAYLOR: Has there not been during the last two, three or four years a very commendable development of the "Do It Yourself" habit? This is one of the best aids to that which we can think of. Certainly in the industries with which my company deals we have seen that development in the last two, three or four years,

aided and abetted by customers, suppliers, and so on. I think this is a natural. I would be willing as a taxpayer to pay out money to people who have not done research yet, but who are gradually learning how to do it.

THE CHAIRMAN: Then I would put you on the opposite side of the fence from your chairman, Mr. Flynn, who is recommending that payments be made not only to those who have not been researching but who are now doing it, but also to all who are now doing it.

MR. TAYLOR: No. I would say to all who are doing it and have been doing it.

COMMISSIONER WALLS: Is there not the danger with all foreign-owned subsidiaries in Canada that the parent company will carry out more of the research in Canada because of the incentive offered, and therefore the Canadian taxpayers will be subsidizing research which would normally have been carried out in the country of the parent organization?

MR. STYLE: May I say a word on this. That could be true, but on the other hand, as the Chairman said at the beginning of the meeting, it is most important for us in Canada to find employment. Here we are talking about employment for scientists and engineers who today are largely drifting down to the United States and other places for lack of employment.

So far as foreign owned subsidiaries

are concerned, I think the best way of getting more research and development done in Canada is to make the conditions such as it would be worth while to the parent company to have it done in Canada and so employ our people. So that there is that side of the question to be considered as well.

MR. COYNE: You are also speaking of more research, Mr. Style, not research which is already done here.

MR. STYLE: Yes, more research.

MR. COYNE: One final comment on this section, and it is to some extent repetitive. In Paragraph 46, after making your further recommendation for a generalization type of incentive at a lower level, as you say in the preceding paragraph, you make the statement:

> "This proposal is intended to provide encouragement to companies which, because they have already been active in carrying out scientific research in Canada and have consistently made large expenditures in this field, are unable to increase substantially these expenditures".

My question is, why do we want to pay for encouragement to companies in that position if the purpose of this incentive is to increase the amount of scientific research done in

this country, and thereby keep trained scientific minds of that sort in Canada rather than lose them abroad? It is the same point and perhaps we have exhausted your comments on the subject, Mr. Flynn.

MR. FLYNN: I mentioned, Mr. Coyne, that this seems to be a little inconsistent, but nevertheless I think there are cases where research, having reached a certain level, you might say, in some industries, if they can be encouraged to increase that, then well and good, and I think they should be. Possibly this does not quite express it if we say that they get 110 per cent of the total research expenditures regardless of whether they are up or down. I am inclined to agree that if research effort went down they should not get any 110 per cent. Have you any comment, Mr. Style, on that?

MR. STYLE: I cannot comment on that because I do not know.

MR. FLYNN: Mr. Taylor, have you?

MR. TAYLOR: No.

MR. FLYNN: I am left with it.

MR. COYNE: Well, I think we have dealt pretty exhaustively with that and gathered the substance of your point here. Then I was going to turn over, Mr. Chairman, to page 23. I was not proposing to ask any questions on the intervening pages, where the position of the Association is made quite clear.

THE CHAIRMAN: You are skipping in fact the incentive based on increased sales, which is now out, and they do not have much to say on that. Also the development of new projects. It is doubtful whether the incentive would ever be effective in achieving its objective except in areas of slower growth. Perhaps someone will wish to ask a question about slower growth before we move on. I suppose there are a number of different kinds of incentives which might be applied to areas of slower growth. As far as taxation is concerned, it seems to me that the most complete one would be a tax holiday. I do not suppose under the heading of taxation one can offer any more than simply remitting all taxes, and that would be complete. I should have thought that that would be the one which would appeal to this sort of purpose. In fact, many other countries have used tax holidays for that purpose. You are not prepared to recommend that, are you?

MR. FLYNN: Again we feel that there is danger in the discriminatory aspects of this thing as between industries or areas, and it might encourage the development of uneconomical operations in certain areas.

THE CHAIRMAN: Very well.

COMMISSIONER GRANT: Would you not leave that up to industry to decide in their own solid judgment, Mr. Flynn? Say the legislation was there. It would not be put into operation

unless industry decided to take advantage of it. If they decided to take advantage of it, they would do it after arriving at what they regarded as a sound business decision. What possible ill effect could that have if you followed on such a course as that?

MR. FLYNN: One possibility, I think, is that a particular manufacturer might go into a particular area and might get into the production of a certain product, and in a tax-free holiday would be able to undercut someone already established in the business, possibly in the same vicinity within a few miles.

COMMISSIONER GRANT: I think geographically the areas have been designated on quite a wide basis, so that "a few miles", I do not believe, would be applicable so far as the competitive angles are concerned. I think you would have to go many miles to compete with a similar industry.

MR. FLYNN: Well, there is the example of the uproar about Brantford opposite the Grand Valley area. I think that people in the Guelph-Galt-Kitchener area --

MR. TAYLOR: Hamilton too.

MR. FLYNN: -- and Hamilton too, are concerned with the possibility that someone may set up shop in Brantford and have a definite advantage in the next few years anyway. Mr. Taylor, you come from that part of the world.

MR. TAYLOR: I got my one word in -- Hamilton.

MR. STYLE: I might just say here that the danger I can see is that there are many industries in this country, as you gentlemen know, which are overcrowded. In other words, we have too many people jostling for a small market. There is the danger, in spite of the wisdom which you gentlemen attribute to industry or the manufacturer, of more companies setting up business to their immediate benefit and making a situation which is already bad even worse. I do not know how you avoid that danger, but it is there. I am referring to setting up because of the immediate tax holiday or tax advantage which they can get, when really they should not even come into that business in Canada in the first place.

COMMISSIONER PERRY: Would this not be a danger with all tax situations? You would have new companies springing up all over the place. That is probably a facetious remark, but it does seem to me that you can carry the argument a little too far.

MR. STYLE: I do not think it would in that case because there is no competitive advantage.

THE CHAIRMAN: I think that Mr. Style's point is well taken. If you give certain people a competitive advantage on condition that they go

into business, they may go into business for that very reason. These people would then upset the producers when they should not be there in the first place. Is there anything else on that point?

MR. COYNE: Well, Mr. Chairman, I will now move on to the next one, which is dealing with incentives to encourage increased Canadian ownership. I did have one or two questions in connection with exports.

THE CHAIRMAN: In summary it is recommended that we encourage Canadian ownership without discriminating against foreign ownership in such a way that it is recognized as being discrimination. Is that what I gather?

MR. FLYNN: That is essentially it.

MR. COYNE: Mr. McDonald this morning pointed out certain aspects of the corporation tax recommendation which he felt was consistent with this. That is correct, Mr. Flynn, is it not?

MR. FLYNN: Yes. In other words, to encourage the equity ownership by Canadians of Canadian companies.

MR. COYNE: Yes. On the next question --

THE CHAIRMAN: Before you go on to that, I think it should be recognized under this heading that Canadian investors in Canada who are investing in Canadian industry already have, I would have thought, a couple of very fair incentives.

One is dividend credit and the other the lack of a capital gains tax. Certainly the United States is not so fortunate. If you were to change the whole scene now so as to relieve Canadian business from all corporate taxation , that is one thing. But as the law stands now this is going further, and it all adds up to quite a lot of money when you compare taxation of an individual in this country with an individual in the United States.

MR. FLYNN: Have you in mind there, Mr. Chairman, in particular the 20 per cent dividend tax credit, or are you talking about the capital gains tax?

THE CHAIRMAN: I have in mind both.

MR. FLYNN: We do not know how much the 20 per cent dividend tax credit really amounts to. I do not know whether your research people have been able to produce any figure on that. We have not been able to get anything on that.

THE CHAIRMAN: I draw your attention to the last issue of the Canadian Tax Journal, which shows calculations in the United States, Canada and western countries in this regard.

MR. FLYNN: I saw that. The Canadian taxpayer isn't much worse off than the American.

THE CHAIRMAN: He is better off on investment income.

MR. FLYNN: He is better off on investment income.

THE CHAIRMAN: Quite substantially.

MR. FLYNN: But answering part of that question, I would definitely not be in favour of a capital gains tax. The experience in England, I am told, in the first six months with regard to their short term capital gains tax is that they have mainly been faced with capital losses.

THE CHAIRMAN: The English deny that is a capital gains tax. They state, in fact, that it is not a tax on capital gains but on speculation. Are you satisfied we are taxing our speculators adequately in this country?

MR. FLYNN: I will duck that question, Mr. Chairman.

THE CHAIRMAN: Yes, I think you had better duck it, because it is very hard to answer. But that is what the English law was directed to. There are not really many countries that will say they have a capital gains tax, other than the United States. Most of them attempt to tax speculators.

England, of course, was brought to that tax because of the desire for social justice, I think, and taxation on speculation, which they did not believe they could achieve without that law. Anyway, I take it you are against a capital gains tax, and by that you mean strictly speaking a capital gains tax and you are not saying you are against a tax on speculation? I say this particularly because in the same sentence in which you refer to the tax on capital gains, you refer to England.

MR. FLYNN: Yes. I was regarding the English law as a capital gains tax without the sort of basic purpose behind it. But as to a tax on speculative gains, I say I would not give an opinion on that.

COMMISSIONER GRANT: There is a question which I should like to ask the delegation which involves foreign ownership and Canadian subsidiaries. It has been put to me that sometimes a company operating in Canada as a subsidiary of a foreign-owned parent company is allowed to accumulate its earnings or retain its earnings when it is wholly owned by the parent corporation and all the shares are owned by the parent corporation, and the parent corporation does not require or call for a dividend payment. So that all profits after tax are retained by the Canadian subsidiary.

It has been put to me that this offers unfair competition to the Canadian company doing business in the same field, which has to go into the money market to raise its capital, and is obliged, in order to maintain its standing, to pay dividends or at least to pay

interest on its borrowed capital. I do not know whether this exists or not, and I do not know whether there is anything that could be done about it if it does exist. However, I should like to use this as a sounding-board to find out whether there are any opinions on it.

MR. FLYNN: Perhaps Mr. Taylor will try and answer that one.

MR. TAYLOR: I do not really have any opinion on it, except to say why should not the American company leave its earnings here, and why should not it then provide competition? At the moment I cannot see anything wrong with the present situation.

MR. STYLE: Of course, the Canadian company is equally able to not pay dividends and retain earnings, and then it generates its own money for capital expansion. Canadian Steel for years, for instance, did not plough back all their earnings, and I do not think they suffered for it.

COMMISSIONER GRANT: It might not be a good idea as far as Sir James Dunn is concerned.

MR. FLYNN: I would think that on balance it is a better thing for Canada. It is not a bad thing.

THE CHAIRMAN: What is?

MR. FLYNN: That the American or British subsidiary here should do that.

THE CHAIRMAN: I am sorry that Mr. Frank Capon is not here at the moment.

MR. FLYNN: I know that he has different views. Mr. Willmot, have you anything to say about this?

MR. WILLMOT: By and large I have to agree. I

do not think it is really a problem. I do not think Canadian companies that pay dividends are necessarily at any disadvantage. I would like to see those funds stay in Canada and be reinvested in Canada.

COMMISSIONER GRANT: I am very pleased to get your views on this subject, because I have been faced with this question on several occasions and now I can at least report what you have said.

MR. TAYLOR: Any investment decisions that would be made would not have regard to those things you have mentioned anyway, but to the new revenue that could be produced by the capital investment, whether by the Canadian subsidiary of an American parent or a Canadian company.

COMMISSIONER GRANT: I think we could classify this, perhaps, as an instance of doing business in Canada, and that is acceptable.

MR. FLYNN: Mr. Watson, possibly you could say something about this. You are in competition with American companies in this regard. Have you found this?

MR. WATSON: No, frankly we have not. I do not think the point has arisen. I would agree with what Mr. Taylor said, that they are on all fours. If, on the one hand, the money remains in Canada and is invested, presumably in something productive and creative of employment, I cannot see any difficulty. The other point is that if it is sent over in dividends, it reflects somewhat on our balance of international payments. I have not given it any thought, but offhand

I would say that I cannot see any economic damage taking place as a result.

THE CHAIRMAN: Thank you. Mr. Coyne?

MR. COYNE: In the section dealing with incentives for exports, which starts at the bottom of page 22 and goes over the page, you comment on proposals which have been made from time to time for an incentive of this nature, and conclude that it is unsatisfactory. In paragraph 60 you state:

> "On the other hand, unfair tax discrimination would arise among taxpayers under incentives which result in lower taxation on profits from the export of goods than on profits from the sale of goods in the domestic market. While exported goods must compete in foreign markets, it must also be recognized that domestic sales also involve competition with foreign goods imported from mass-producing low-cost countries."

I put it to you that at the present time and throughout recent history, I suppose, we tax exported goods less heavily than goods consumed domestically, by reason of the exemption from and/or drawback of customs duties.

Would the Association feel that these provisions whereby goods that are exported from Canada are taxed less heavily than goods consumed here involves

the same unfair tax discrimination that you feel would be involved if there were discriminatory rates of income tax? Does the same sort of reasoning apply?

MR. STYLE: I would say no.

MR. COYNE: Why?

MR. STYLE: What you are saying is that imported goods are taxed in the form of tariffs, first of all -- customs duty -- and then a sales tax within the country.

MR. COYNE: I am putting it the other way. I am saying that if you produced goods in Canada for sale, you pay sales tax on the goods, or the customer does; and also, to the extent that there are imported components involved, you are paying customs duty.

If you export those same goods abroad, you do not pay the sales tax and you receive a drawback of any customs duty paid on components going into Canadian manufacture. I am simply asking you whether these two situations are comparable. You state that you would be opposed to taxing profits earned on foreign sales at lower rates than profits earned on domestic sales, and I am really asking, does the same sort of reasoning apply in respect of taxes that are imposed on goods, which are of course much heavier on goods consumed domestically than on goods which are exported?

We do have discrimination as far as taxes on goods are concerned today. Is there any reason why a different type of reasoning applies in the case of income tax on profits earned abroad rather than domestically?

MR. STYLE: In other words, if you assessed against export the same degree of taxation, which would include your sales tax, which actually in a sense the manufacturer does not pay because it is the Canadian consumer who pays, you would immediately become non-competitive in the foreign markets. The profit ratio you might make might be the same, and many of those goods you are exporting may have to pay sales tax in another country.

MR. LANG: Perhaps I might add that under the GATT arrangements it is generally recognized that export drawbacks and also domestic sales taxes should not be included in prices for export. In other words, it is a matter of being able to compete on an interantional level. If we followed the practice which is followed by every other country and we imposed, as you say, the same amount of tax on our exports as we do on domestic goods, we would not be competitive internationally.

MR. COYNE: I understand this perfectly well, but I was just a little curious as to why you object to differential rates of income tax on profits earned abroad, as against profits earned in Canada, and at the same time feel it is satisfactory and indeed universally practiced that the taxes on goods exported abroad are lower than the taxes on goods consumed domestically.

I would have thought that manufacturers selling solely in the home market might feel discriminated against, in these circumstances.

MR. STYLE: I think that perhaps the answer to this is that in the case of a differential tax

between export and what is sold in the domestic market you have got discrimination between the manufacturers manufacturing 90 per cent for the domestic market and manufacturers manufacturing 90 per cent for the foreign market. That discrimination does not apply to sales tax or drawback on duty.

MR. STRUDLEY: If the sales tax is meant to be a tax on Canadian consumers, there is no particular reason why Canadian consumers should pay a sales tax on goods being consumed in Detroit or in Buffalo.

MR. COYNE: This may be the answer. This may be what your reasoning leads to.

MR. STUDLEY: If you differentiate between consumption tax and income tax on that basis, that seems to be pointing in the direction of an answer.

THE CHAIRMAN: It is only valid, of course, if you do not say that the instance of corporation tax is the same as consumption tax. If your customers bear corporation taxes, it does not apply.

MR. COYNE: On the same page, the next section of your brief deals with capital cost allowances, and in paragraph 61 you state, in the second sentence:

> "The diminishing balance method of writing off assets is undoubtedly preferable to the former straight line method."

I wonder if you would explain why you say that the diminishing balance method is undoubtedly preferable. Is this because of the accelerated depreciation factor that we were speaking of earlier, or is it for some

other reason.

MR. FLYNN: I think, Mr. Coyne, possibly there are two reasons. Many people did not agree with choosing the balance method when it was first introduced in 1949 and it was realized then that the system could work in an anti-cyclical way, that would be inflationary in good times and deflationary in bad times. But we seem to have got over that hump and I think today possibly the reducing balance method is favoured because of the slight incentive aspects where you do get, so long as your capital expenditures are maintained, you do get some tax relief that you would not have got under the straight line method. But secondly, I think from a purely administrative point of view it is a great deal simpler.

MR. COYNE: That was my second question really -- whether you were thinking in terms of administration of capital cost allowances or altogether thinking about the immediate tax effects of the two systems.

MR. FLYNN: I think both.

MR. COYNE: Although it is not really a slight advantage, is it? Does it not amount to 100 per cent acceleration in the first year of depreciating assets? When the diminishing balance system was introduced the previous rates went up.

MR. FLYNN: The rates went up but in actual fact life expectancy was extended for assets. The former 10 per cent rate, which was a 10-year life expectancy, is, if you take it to its logical conclusion, now about 17 years. However, the advantages gained I think more

than offset that because you can now recover capital losses through the diminishing balance method over a period which you could not under the straight line system.

What would you say, Bob?

MR. STYLE: My thought was this, that in an age of increasing mechanization and automation, depreciation is an application more and more of obsolescence than deterioration. Obsolescence is much more uncertain and it is guarded against by taking it more quickly so long as your customer will pay you for it.

THE CHAIRMAN: Are you trying to suggest it is a good way to measure income?

MR. STYLE: Diminishing balance as opposed to straight line?

THE CHAIRMAN: Yes.

MR. STYLE: In what I have just said, yes. I do not say that is true. I do not know any true way of measuring income.

THE CHAIRMAN: No. The best was all I put to you.

MR. STYLE: Given the proviso that we have that, you must report to your owner periodically whether you know your income or not. You have to report what you think it is.

THE CHAIRMAN: As best you know, how in your company is it based? Is it based on straight line or diminishing balance? I suspect it is on straight line.

MR. STYLE: It is straight line amended by an

activity ratio.

THE CHAIRMAN: I think generally throughout the community that is the case and in fact the ten largest companies in Canada do not use the diminishing balance method; they have equalization reserves on the balance sheet. I cannot say they use a straight line either; I do not know. However, they are not claiming as much depreciation for reporting purposes as they are for taxation purposes. So long as that is the case, it does not seem to me that you can make much sense of the argument that diminishing balance is the best way to measure income.

MR. STYLE: To measure income, no; I would agree with that.

THE CHAIRMAN: I would wonder if it should be permitted for taxes. Why should this incentive creep in here rather than a clearly defined incentive for certain purposes? I have never heard of it justified. Why should a certain part of industry get a break over others? Public utilities, such as the hydros which use vast amounts of capital are getting write-offs way above what they are reporting or claiming. I doubt whether that is a good system on those grounds. If we are going to have an incentive, let us face up to it and say that there is an incentive and let us put it into the Act. I think this must cost the government millions of dollars. I had something to do with putting this system in and I once thought it was a very good system. I am trying to provoke you to defend it. It does not seem to me that it stands up well as a measurement of

income.

MR. FLYNN: Mr. Chairman, as you know the accounting profession is divided on the subject. As you say, most large companies operate on the straight line basis for their own purposes and some reserve the immediate tax saving they make and some do not. The profession is divided on that particular point.

THE CHAIRMAN: I am not talking about the method of reporting.

MR. FLYNN: I think probably the reason why industry thinks the capital cost allowance system is reasonable is the simplicity of operation, and also while they are expanding they do get an interest free loan from the government.

MR. COYNE: This is an incentive of which you approve?

MR. FLYNN: I am not going so far as to say that because I still have misgivings about the system myself because, again, I think it is anti-cyclical.

MR. COYNE: We have been speaking about the existing capital cost allowance system, but in paragraph 62 you recommend the introduction of what I suppose is rather loosely called the free-depreication system. That is to permit owners of capital assets to depreciate those assets or to take allowances for those assets. At any rate, they choose up to 100 per cent in one year, I presume. Perhaps this is the extreme position that raises the question as to the distortion of the proper capitalization of income.

MF. FLYNN: It is the logical extension of the

capital cost allowance system.

THE CHAIRMAN: Did you say logical or illogical?

MR. FLYNN: It could be either, but I used the word "logical". I think perhaps your thought is better.

COMMISSIONER PERRY: It is the logical extension of an illogical system.

MR. COYNE: On this point, has the Association made any calculations or given any consideration to the immediate revenue effect of introducing a re-depreciation system? One calculation I have seen suggests it could amount to a reduction of $1,100.00 million in the first year of the system in tax revenues.

THE CHAIRMAN: That is about all our tax gone, is it not?

MR. COYNE: That is just about the whole of the corporation tax revenues for that year. I think that is on the basis of 100 per cent write-off of all new assets bought in that year and ---

MR. STYLE: What would you get the following year?

MR. COYNE: It is a good point.

THE CHAIRMAN: This deals with write-off of assets purchased in one year. You would presumably get something like it the following year.

MR. STYLE: It is a loan of that amount to industry.

MR. COYNE: I suppose on this thesis it means postponing any take from the corporation tax structure for one year.

THE CHAIRMAN: And the cost to the government would be the interest on the tax that they would have collected on the other basis, and it would be a colossal amount of money.

MR. COYNE: You have not made any study of what manufacturers might do if they had this option? Presumably they would not all take the 100 per cent in one year.

THE CHAIRMAN: Why not?

MR. COYNE: They would have to pay for it next year.

MR. FLYNN: Capital.

THE CHAIRMAN: New capitalization in all business is something like $5 billion.

MR. FLYNN: $3.629 billion.

MR. COYNE: If we might turn the page to the next section which has to do with investment reserves, perhaps I might ask you the same question I asked earlier in another context. Is this recommendation in addition to or in substitution for some of the other recommendations you have made, as for example the granting of investment allowances, the setting up of free depreciation, the reduction of tax and the like.

MR. FLYNN: In lieu of reduction of tax. You can take it that if there were an adequate reduction in the tax rate there would not be the pressure for introducing nor the wish to introduce many of these other measures.

MR. COYNE: This is in the same category, then, as the others we spoke of a short while ago?

THE CHAIRMAN: Mr. Coyne, would not this investment reserve suggestion be practically the same thing as free depreciation cost? The effect of the proposal is to advance the depreciation. When you buy the assets out of reserves you are not allowed to take any more depreciation. So in fact, you have the depreciation all at once. Is that not what you would have here?

MR. FLYNN: I suppose really it is.

COMMISSIONER WALLS: Am I to interpret from paragraph 65 that you only wish this investment reserve to be applicable to manufacturing and processing? I wondered about transportion companies. Are they not entitled to investment reserves and do they not need it just as badly as manufacturing and processing industries?

MR. FLYNN: Probably, yes.

COMMISSIONER WALLS: Your paragraph there reads as though you only wish it for your own industry.

THE CHAIRMAN: By the way, the Swedes have extended this to inventories but there is not a Swede who supports the view that it is properly applicable to inventories as far as I can find out, and that includes government.

They have brought them in recently, but they all disagree with it. They say it does not work.

COMMISSIONER PERRY: This in its present form looks like a very obvious loophole. The essence of the Swedish system is that it must be spent on the investment. This leaves it to the discretion of the taxpayer, and it seems to me you can go on putting aside a

reserve and not spending it for five years, just bringing it back into income, and you could go on doing this forever and have a very substantial postponement of tax.

THE CHAIRMAN: No interest.

COMMISSIONER PERRY: It is not that I am opposed to this, of course.

THE CHAIRMAN: I am opposed to someone else having it!

COMMISSIONER PERRY: At the minimum it becomes a very easy way of averaging income and at the other extreme it is quite a substantial tax saving device. It is not acceptable in its present form.

COMMISSIONER GRANT: Mr. Chairman, the Association advocates one corporate tax rate, which means of course that we would do away with the dual rate which we have now, impliedly. If the rate is 40 per cent, as has been mentioned, you would recognize the fact that this is going to place some hardship on the companies whose profits today do not exceed $35,000.00 up to $50,000.00.

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But you have not come forward in your submission with anything which would ease the burden which this single rate would thus impose upon a smaller corporation. Do you think that investment reserves may be made applicable to earnings up to a certain point, or have you given it any thought?

MR. FLYNN: Mr. Grant, I think, first of all, that we have not specifically suggested in this submission a 40 per cent rate. That figure came out in discussion this morning but it is not, shall I say, a firm recommendation of the Association at this time. It was used this morning for a different purpose. To that extent I think I should say that we have not really got down in this brief to what would happen with a flat 40 per cent rate as compared with a graduated rate.

THE CHAIRMAN: Mr. Grant says, can you visualize giving the small companies a special rate by way of a Swedish reserve?

MR. FLYNN: We would have to think about that. It might be necessary to do something about the smaller companies, but there we come back to what I have been saying about discrimination.

THE CHAIRMAN: You have the definition of "small companies". You have to decide whether you need private or small companies.

MR. COYNE: There are just two small questions on the next section having to do with contributions to pension plans. You recommend that the $1,500.00 annual limit on contributions by employers to employees pension plans or deferred profit sharing plans be raised

considerably or entirely removed. The question I want to ask is, what about the limitations on employees own contributions? Do you suggest that they should also be removed?

MR. FLYNN: That is the employee contribution?

MR. COYNE: Yes.

MR. FLYNN: I think really they would go together, but our principal thought at the moment is that the $1,500.00 is inadequate. It might be doubled or increased somewhat. But we realize that possibly more problems would be created if it were removed entirely. In other words, there have been abuses of the thing, we understand. Actually, what we would like to see is for it it be raised.

MR. COYNE: For it to be raised?

MR. FLYNN: Raised from the $1,500.00.

MR. COYNE: Without suggesting any specific limit that it be raised to?

MR. FLYNN: Well, possibly $3,000.00 or $3,500.00.

MR. COYNE: You said that it is inadeqaute, Mr. Flynn. I suppose it is inadequate in respect of certain employees earning large sums of money.

MR. FLYNN: That is so.

MR. COYNE: But to the extent that it is one of the problems which we were discussing earlier on, if he is permitted to defer a larger portion of his tax, then you and I and the rest of us have to pick up the time in the meanwhile.

MR. FLYNN: Yes. But I think that this was

introduced to preclude outright abuses, where people would put fantastic amounts of money into some of these plans. What we are getting at is where you have 2,000 employees, or a few hundred for that matter, and you get trapped by this thing with your salaries, depending on the rate of contribution. I mean the disallowing of contributions in respect of salaries in excess of $18,000.00 to $20,000.00. That causes a lot of administrative difficulties.

MR. COYNE: Of course, these limits have always been in there from the outset, and I suppose they were originally intended to provide relief by way of tax deferment within certain limits wherein it was thought reasonable that tax relief should be granted.

MR. FLYNN: At that time. It started at $900.00 and was then increased to $1,500.00, which is where it has been for the last few years.

MR. COYNE: And your point is simply that it should be increased.

COMMISSIONER PERRY: Actually it started at $300.00, in 1936 I think, actually.

MR. COYNE: Then there is one other matter in paragraph 66, the statement is made that:

"Since pension plans themselves are subject to registration with the Minister of National Revenue before contributions may be deducted from income for tax purposes, there exists an adequate safeguard against excessive contributions by employers

to pension plans."

I found that statement a little confusing, and I was wondering whether you could indicate what you mean there. Are you suggesting that there should be regulations respecting these plans, or that the limits should be determined by ministerial discretion rather than fixed by statute?

MR. FLYNN: I do not think we include ministerial discretion. I think Mr. Perry can probably answer this better than I can, frankly, because the registration plan today seems to be a little vague anyway, the blue book having gone out, and so on. Basically the Department is approving a contribution at a rate of 5,6 or 7 per cent. I do not think they have looked into at the present time -- well, I think they made sure that it is equitable amongst all employees under a registered plan. I think that is what is intended here, that if this is done you are not going to find the president putting $50,000.00 into the pension plan of the company when the employees are only putting in $250.00.

MR. COYNE: You are not suggesting that the Minister of National Revenue should fix the limit which you say should be increased?

MR. FLYNN: No.

MR. COYNE: Well, Mr. Chairman, I was going to pass on to personal income taxes.

THE CHAIRMAN: Just one comment on cooperatives which I want to make, and perhaps there are one or two others which somebody else up here would like to make.

I observe what you say about cooperatives. So far no one has recommended to us that corporations be taxed on the same basis as cooperatives, and I am not assuming that you are making any such recommendation. You say in paragraph 70 that the best solution to the cooperative problem would be to abolish corporation income taxes. As you probably know, cooperatives are required to distribute their income annually, and as such they are probably bearing some resemblance to an ordinary partnership. While they are not taxed in the same way, they are taxed in a not dissimilar manner. On the other hand, corporations are not required to distribute their income and can use their own discretion. Consequently the scheme of taxation is entirely different. I do not think that you would suggest for one moment that corporations would like to be taxed as cooperatives.

MR. FLYNN: No, I do not think we are suggesting that.

THE CHAIRMAN: I do not think you are either.

MR. FLYNN: Before we leave that I think this point should be clear. As an association we have not recommended the abolition of the special tax treatment of small companies. This may have come out this morning apart from the brief. I should like to make it clear, however, that we are not recommending at this stage that the tax advantage -- in other words, the 21 per cent on the first $35,000.00 -- should be taken away from the smaller companies.

THE CHAIRMAN: You are not?

MR. FLYNN: No.

THE CHAIRMAN: I gathered from some comment which I heard earlier that you were in fact so recommending.

MR. FLYNN: No. That is why I want to clarify this, because that came out this morning in visualizing a 40 per cent rate and what might happen. But that was purely a hypothetical example and does not form part of the Association's submission at this time.

THE CHAIRMAN: May I assume the contrary then, that you are suggesting that there should be a step in the rate and that it should be maintained?

MR. FLYNN: At the moment I think that is so.

MR. COYNE: If you are going to maintain it under a fixed corporate rate at 40 per cent, and allow a 50 per cent tax credit for dividends paid to Canadians, you will bring the corporate rate down considerably below 35 per cent, probably closer to 30 per cent.

MR. FLYNN: Yes. Well, Mr. Chairman, this is an area that we speculated on this morning. I should like, if possible, to suggest that we stick to the brief so far as our formal submissions are concerned, and that these thoughts this morning were pure speculation about what might happen under certain circumstances. But I think we have to give considerably more consideration to this aspect to give a firm view on the subject.

THE CHAIRMAN: If you would like to write an opinion on it we would be glad to have it. I take it that you are recommending basically that if corporation

taxes are to be continued in steps, but that the rates of corporation tax be reduced ---

MR. FLYNN: As we see it at the moment, yes.

THE CHAIRMAN: But your recommendation is the elimination of corporation tax. Is that correct?

MR. FLYNN: I do not quite go as far as saying that. We visualize that the day may come when corporation taxes could be eliminated. But that is a long term proposition.

THE CHAIRMAN: Thank you. Is there anything further on personal income tax?

COMMISSIONER PERRY: I should like to say on Mr. Flynn's behalf that I have read this brief and found that it was silent on the reduced rate, and I assumed that you had nothing to say on the subject.

MR. FLYNN: That was put in as a hypothetical example.

MR. COYNE: I think it arose during the course of discussion this morning, and that is all. I think I asked the question whether it was not inherent in the type of proposal you make in section 29 of your brief that there would have to be only one rate at which tax was being paid on the corporation's earnings. There are all sorts of ways in which the effect of that tax on small companies of that sort may be mitigated in various ways, but the statement made this morning was that in the sort of proposal you put forward in paragraph 29 it necessarily meant that there was a single rate of tax being charged in the first instance.

MR. FLYNN: I think that was the way it came up

this morning. Before letting that become a recommendation of the Association we should like to think more about it. There are many aspects to it. Various permutations and combinations of how that scheme should work could be arrived at.

MR. COYNE: Well, Mr. Chairman, in the section on personal income tax which appears at page 28, commencing with paragraph 72, I think, Mr. Flynn, that your basic position as set forth in paragraph 73 is this. You say:

> "It is the view of the Association that the present rate structure and level of personal income taxes are far too high for the good of the economy. The present steeply progressive rate structure has undoubtedly a tendency to discourage initiative, affecting particularly executives, managers, engineers, top salesmen, those employed in all levels of scientific research, technicians and other skilled employees",

and so on. The only question I was proposing to ask you was this. Do you have anything more specific to say about personal income taxes with regard to what they should be if they are now too high? Also, have you any specific evidence or information substantiating these ill-effects which you attribute to them in this paragraph and in the other paragraphs?

MR. FLYNN: I think that any tax revenue raised over the, shall we say, 60 per cent rate produces very little revenue to the government; but I think psychologically it has a very bad effect on the individual. It is hard to measure that, and presumably as the loss of revenue is not great, the advantage to the individual is not great in the aggregate, but I think it is psychological. Do you have anything to add, Mr. Watson?

MR. WATSON: I would agree with Mr. Flynn on that. This is one of those cases where, as he says, the value is not very great. You can only imagine the feeling of multi-millionnaires, who feel they are held back beyond a certain point. It is general. It is more philosophy, in a sense, perhaps than economics; but there is that feeling. I have discussed it with some of them. I have a few multi-millionnaire friends and I have found their thinking to be along those lines.

I do not think you can measure it, but I think it is there.

COMMISSIONER PERRY: I find that I am puzzled when executive gentlemen consider a question I sometimes I ask, as to whether they would take longer or shorter holidays if there were no income tax.

MR. TAYLOR: Or more.

COMMISSIONER PERRY: Or more. I just have a feeling that with twice as much income, people would take an extra two or three weeks holiday.

THE CHAIRMAN: I am not at all sure. If one took more of one's pay away, he might work harder to make up the difference. You will recall that when inflation

cut down the amount of insurance provided, the insurance companies had record sales. It might work in exactly the opposite way.

MR. COYNE: I suppose there are two aspects to this general problem of rates, Mr. Flynn. One is the top level that they should lead to, and I think that is the point you and Mr. Watson have both been speaking to. The other aspect is the rate of progression by which the top rate is reached. Does the Association have any particular ideas on that aspect of it?

MR. FLYNN: We have no definite recommendations. We do feel that the rate of progression is a little too steep. I will put it that way. But, again, we come back to what alternatives might be introduced, and at what cost to the revenue.

MR. COYNE: I have seen it done. If you illustrate the rate of progression in graphical form, you will find it is far steeper at the sort of area of $1,000.00 to $4,000.00 worth of income, and then it slopes off very markedly once you get up to about $8,000.00 or $10,000.00 worth of income.

MR. TAYLOR: It starts at zero, and therefore that must be the result.

MR. COYNE: No, not starting at zero, but starting at 11 per cent, which I believe is the lowest rate in the scale.

MR. STRUDLEY: If it did not flatten out it would be getting to about 150 per cent of income, or something like that.

MR. COYNE: Anways, you are not offering any

specific suggestions or recommendations in this matter at all?

MR. FLYNN: No.

MR. COYNE: I have no other questions on that aspect of it, Mr. Chairman.

THE CHAIRMAN: I might just put one question on that. I would like to know what the choice would be in the way of reducing taxes as between corporations and personal income taxes if the Minister found he could not knock $1 million off the budget. If he knocked it all off personal income tax, I suppose the manufacturers' market would be enlarged. If he knocked it all off corporation taxes, I suppose the manufacturer's profits would be increased; he would then be able to increase his dividends and capital for the expansion of his business.

Would you care to say which of the two would serve the interests of the manufacturers best, or would you say they would be best served by dividing it 50-50 as between consumers and producers? Has anybody ever tried to answer that question?

MR. FLYNN: Which hat are we supposed to wear, Mr. Chairman?

THE CHAIRMAN: I said "the manufacturers" quite plainly.

MR. TAYLOR: How much is involved, Mr. Chairman?

THE CHAIRMAN: $50 million, on my proposition; and I am only addressing it to manufacturers.

COMMISSIONER PERRY: Couldn't you raise the

ante a little bit?

THE CHAIRMAN: Do you think I would get a different answer if I made it $100 million or $200 million? Take whatever you like and give me the answer, or do you say you haven't any idea?

MR. FLYNN: We could always take the middle course, Mr. Chairman, and call it 50-50. What do you say, Mr. Strudley?

MR. STRUDLEY: I think the manufacturer and the personal taxpayer is the same person in a good many situations. I would say, if I were answering this question specifically, that getting some relief on both the personal taxpayer and the corporation would be the fairest answer.

THE CHAIRMAN: I was not asking for the fairest; I was asking for the best solution in the interests of Canadian manufacturers.

MR. STRUDLEY: I think dividing it would be the most practical and fairest in the interests of the nation, which is perhaps what we should be considering.

THE CHAIRMAN: Would that be in the best interests of Canadian manufacturers, or is that the same thing as the fairest for Canada?

MR. STRUDLEY: I think if you go down to just the best interests of Canadian manufacturers, taking the tax off the companies would be the most direct. I do not think that would be the wisest from the national standpoint.

THE CHAIRMAN: As I put it to you earlier, I was wondering whether you are not equally as concerned

with your market for your goods, and to the extent that you give the reduction to consumers you are improving your market for sales. Many people say the action should be wholly on the market; that the producers goods will take care of themselves if the market is there. Manufacturers are inclined to say no; what they need is to improve the quality of their equipment, reduce costs and sell more goods.

MR. STRUDLEY: And produce the prices to perhaps sell more goods; and that would have the same effect as giving the consumer more.

THE CHAIRMAN: In the States when they came to the $11 million cut, they divided it between the two. I am wondering whether you have any ideas which pertain to manufacturers. What would be the best thing for manufacturers? Would it be to put the emphasis on your market, on your equipment, or somewhere in between?

If you have not thought about it, I really do not want an answer, because there is not much good, I do not think, getting an answer right off the bat. It is a tough question and I know it has been the subject of a pretty wide debate in the United States. I do not think it has been debated in Canada very much. Do you people have an answer?

MR. STRUDLEY: No, we have not, Mr. Chairman.

THE CHAIRMAN: Then we will go on to estate taxes.

MR. COYNE: Mr. Flynn, you point out the difficulties, in quite general terms, and disadvantages which are caused by estate taxes, particularly to a small

family-owned business. Then in paragraph 80 on page 30 you make this statement:

"If these unattractive alternatives facing small businesses should have the effect of discouraging the launching of industrial enterprises, Canada will be deprived of needed economic growth."

Is there any evidence that you are aware of that estate taxes have the effect of discouraging the launching of industrial enterprises?

It is often said that they discourage the continuation of family-owned businesses from one generation to the other; but it was a rather novel idea to me, in any event, that they discouraged the launching of industrial enterprises; that is, the fellow starting out to try and make himself a business.

MR. FLYNN: Would you care to comment on that, Mr. Watson?

MR. WATSON: I cannot recall any specific instance of hearing a man say that he has studied the implications of the instance of estate taxes on family corporations, and in the light of what he found out he decided not to go ahead and would rather work for a large corporation. That is the point you make?

MR. COYNE: Yes, indeed.

MR. WATSON: I cannot recall any instance of it. I have heard discussions about it on the pros and cons, and that young men say they will work for a larger corporation because there are a great many advantages to

it, it is a more secure proposition, and so on. But I have never actually heard a case where a man came to the brink and weighed the pros and cons and evaluated them.

MR. COYNE: This is quite a different point. Would you say that as far as existing family-owned businesses are concerned, they tend to discourage the expansion and continuation of those businesses in individual or family hands? In other words, once established, it is a different situation?

MR. STRUDLEY: I think "expansion" would be a better word than "launching" in this context.

MR. COYNE: I see. Then on page 31, in paragraph 82 you make a specific recommendation in these words:

> "Additional measures are required so that the need for cash to pay estate and income taxes may not result in the sacrifice or discontinuance of manufacturing businesses. It is suggested that some relief might be found in the extension of time for the payment of taxes and the issuance of some form of long-term mortgage security in lieu of cash".

I just draw your attention simply to the existing section 49 of the federal Act, which provides:

> "The Minister may, if he considers it advisable in a particular case, accept security for payment of taxes, interest or

penalties under this Act by way
of a mortgage or other charge
on property of the person by
whom such taxes,interest or
penalties are payable or on
property of any other person" --

And so on. Were you aware of the fact that that provision already existed in the statute? Is it because of the shortcomings of the administration of that section that you put forward this recommendation?

MR. WATSON: I was quite aware of the fact that discretion was being used. I was not aware of the actual statutory framework of it. I think this would ease the situation of estates that find themselves in this position. It is essentially the non-liquid assets that form the estate that cause the trouble, of course. That is obvious. I believe that the discretion has been used latterly, from what I hear in talking to estate officers and others who have been in this position, more often than some years ago.

I would like to check on that. How long has that been in the statute?

MR. COYNE: My impression is that this has been in the Estate Tax Act since it was enacted four or five years ago. Whether there was an equivalent provision in the Succession Duties Act, I am not sure.

MR. WATSON: I had some discussion some years ago on the question when several estates did get into a tangle. I think you might take what could be called the unfortunate impact or instance of succession duties

on estates in this position. It might be split in two. One is the actual impact on an estate which is in this position and where the owners of the business during their lifetime have not made prudent provision. There are hardships that have occurred, but I think they are becoming further apart, particularly in this regard.

I think that in terms of economics it is the precautions which are taken and the reactions which act on the owners of the business in their lifetime; their reactions to what you might call this menace. They see themselves locked in by a non-liquid situation and they more or less, as I say, have two ways in which it actually operates. One is that they are forced to make provision for large sums of life insurance. That simply acts as a production cost. Besides that, there is the question of whether they want to have a continuation of succession as they pass it down from one generation to another.

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Where there is no such desire to maintain a succession, then men coming along to their more advanced years say, "We have done all right with this thing and we are just going to watch and take a chance. We are up to 60 now and we will just cash in and get out." More often than not, those sales are made to large corporations, and some of them are foreign owned. We all know that story. While people say yes, there is that discretion today, but what can be given can be taken away. For that reason I think if this has any value it is to reinforce the necessity of keeping that in and exercising it.

MR. COYNE: Perhaps it has not been sufficiently used, Mr. Watson?

MR. WATSON: That again is hard to say. I have discussed it with trust officers and they have put in their brief here and have covered it much more thoroughly than I am able to do, but I think if that is capitalized and brought to the fore and used, I think that -- that and the actual evaluation for tax purposes -- is highly important because the worth of a company at that time is a pretty hard thing to fix because it depends so much on the continuation of management. Large corporations, of course, have two or three echelons of management but small organizations do not have that situation because they cannot afford to have that calibre of people. So the question of evaluation for tax purposes is one with regard to which I would ssy that some time should be allowed to elapse for a deliberate analysis of the worth of the assets to be

made rather than trying to fix it at the date of death or shortly after. That is one thing. Then of course time is a big factor. That has relieved the situation.

MR. COYNE: I take it on that point you are suggesting an option in paragraph 83. Therefore it would still be open for the date of death to be used if it was seen fit to do so, and there should be the option of taking some later date, and you suggest a year?

MR. WATSON: If the executive felt the controlling interest would not depreciate, if they were willing to take that chance, I think it would be a useful object for that. But if a chaotic condition arose, which has taken place, they should be allowed to lean back and say, "We don't know whether to sell, wind up or what-have-you". Then I think that would be a very valuable option and would mitigate the hardship. It would tend, I think -- and I repeat again the reiteration, it is more the sword of Damocles hanging over the head of the small corporation during the lifetime of the people who control it that is forcing them to take steps which in one case increase production costs and in the other case, if they take the other line and adopt ultra conservative policies to keep the liquid assets in shape, then that tends to inhibit growth. I have seen such cases.

A great deal of time and thought and concentrated effort is expended by owners of businesses in this condition during a lifetime to anticipate all these possibilities which could be put to much better

productive purposes. I think that is the main point.

MR. COYNE: Those are all my questions, Mr. Chairman.

THE CHAIRMAN: I think we have no more questions. We did not obtain a reply earlier to the rate of return on capital as compiled annually by the C.M.A., and I suspect you now know what it is.

MR. FLYNN: Mr. Chairman, it is 8.8.

THE CHAIRMAN: Thank you. That is less than what I thought it was and more than you thought.

MR. FLYNN: That is 1962.

COMMISSIONER WALLS: What is the latest figure for dollar sales?

MR. WHITELAW: Mr. Chairman, it is 5.1.

THE CHAIRMAN: We are very much obliged to you. It has been immensely helpful for us to hear your ideas. I am sorry we have kept you so long, but we have only done so because we have been extremely interested. We want to pursue the subject matter here very thoroughly and we very much appreciate the help we have obtained from you.

MR. WILLMOT: May I express our appreciation, Mr. Chairman, to you and to the members of the Commission and to counsel for the very thorough hearing you have given the committee today. We appreciate it just as you do. We are sure the studies are in very good hands for the sort of attitude to the job that we are seeking.

THE CHAIRMAN: Mr. Secretary, is there anything more?

THE ADMINISTRATIVE OFFICER: Nothing more, Mr. Chairman.

THE CHAIRMAN: The proceedings will stand over until 9:30 in the morning.

---The hearing was adjourned at 4:20 o'clock p.m.